



The Actuarial Profession

making financial sense of the future

Life conference and exhibition 2011
David Prowse & Clara Hughes, Fitch Ratings



UK life in 2011 and beyond

A rating agency perspective

20-22 November 2011

Agenda

Credit Ratings

UK Life Market – Metrics

Solvency II

Looking Ahead

Q&A

Credit Ratings

Purpose

- Security / financial strength

Meaning

- Probability of default / loss given default

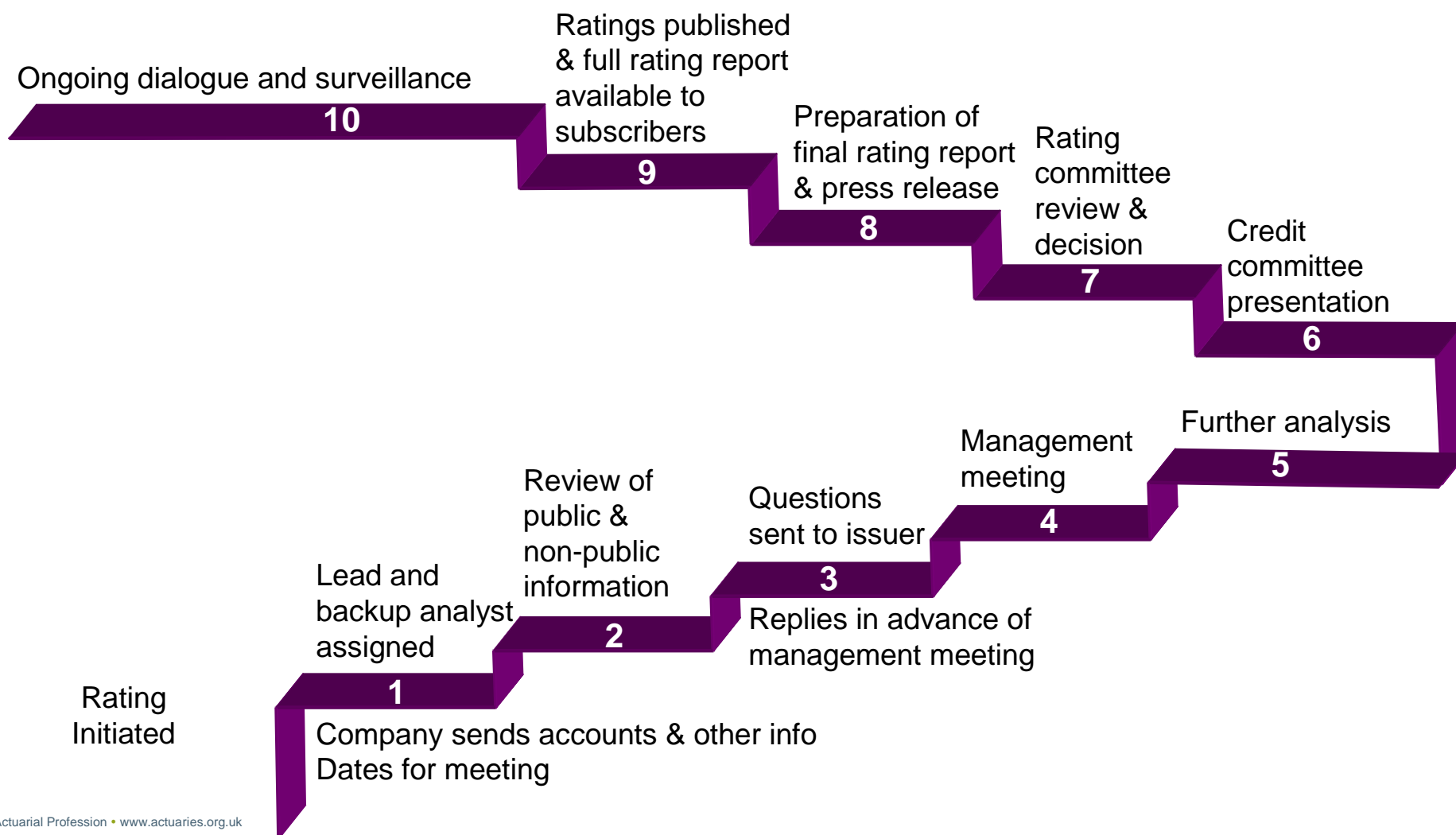
Users

- Investors
- IFAs / policyholders
- Actuaries

Implications

- Cost of finance

Steps in the Rating Process



Analytical Methodology – Overview

Financial profile	Sovereign-related constraints	Industry profile	Market position	Ownership and governance
Profitability	Country ceiling	Competitive landscape	Underwriting expertise	Ownership
Investments and liquidity	Transfer and convertibility risks	Pricing trends	Distribution capabilities	Corporate governance
Loss reserve adequacy	Overseas assets	Competitive advantage	Business mix	Management quality
Reinsurance utilisation	Foreign strategic partnerships	Barriers to entry	Market share	Organisational structure
Catastrophe risk	Creditworthiness of government	Bargaining power	Operational scale	Group synergies
Capital adequacy		Tail of losses	Expense efficiencies	Parental support
Financial flexibility		Regulatory environment	Brand recognition	Strength of subsidiaries
Peer analysis		Accounting framework	IT capabilities	Financial projections

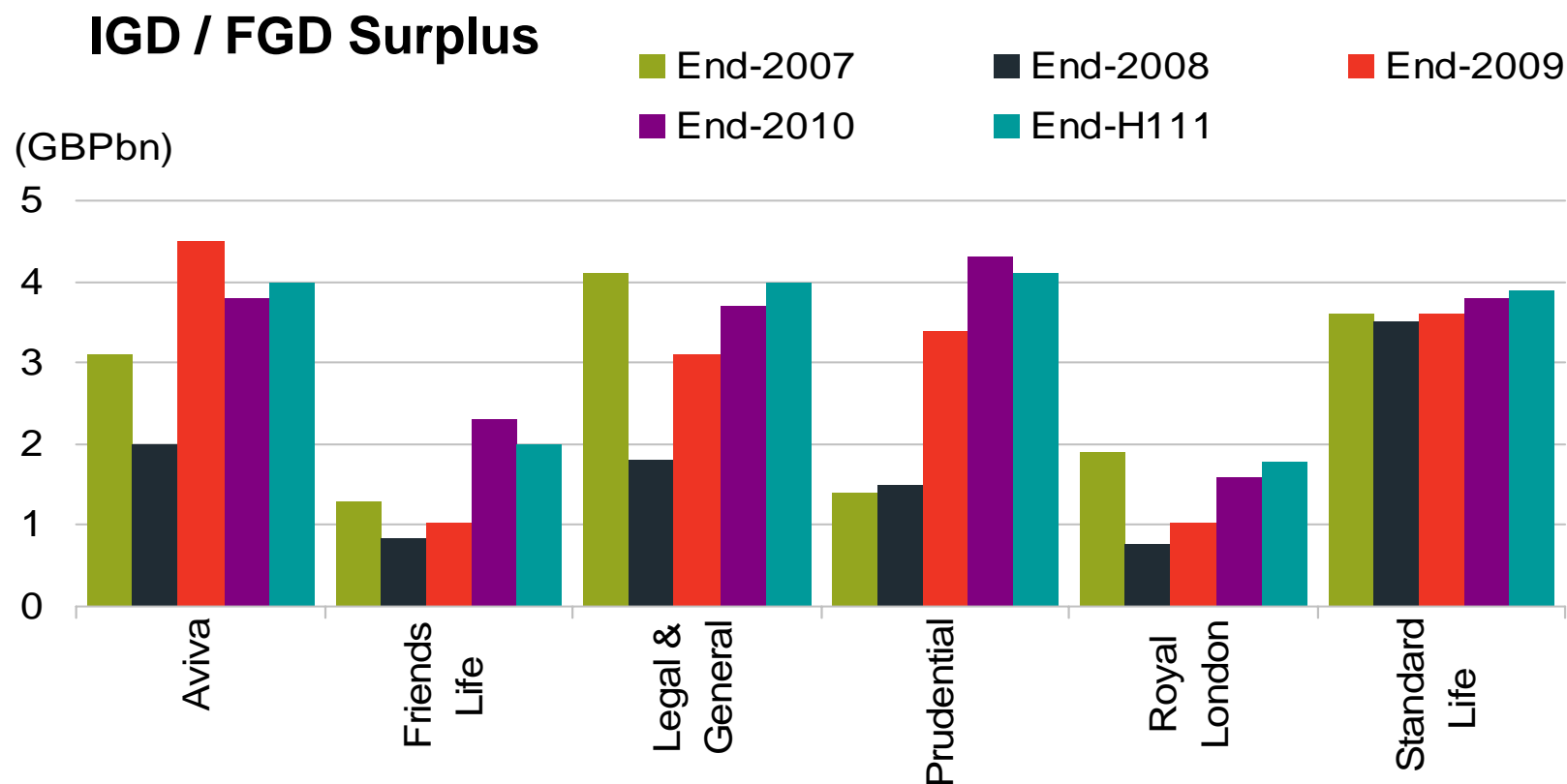
Analytical Methodology – Selected Key Drivers

Financial profile	Sovereign-related constraints	Industry profile	Market position	Ownership and governance
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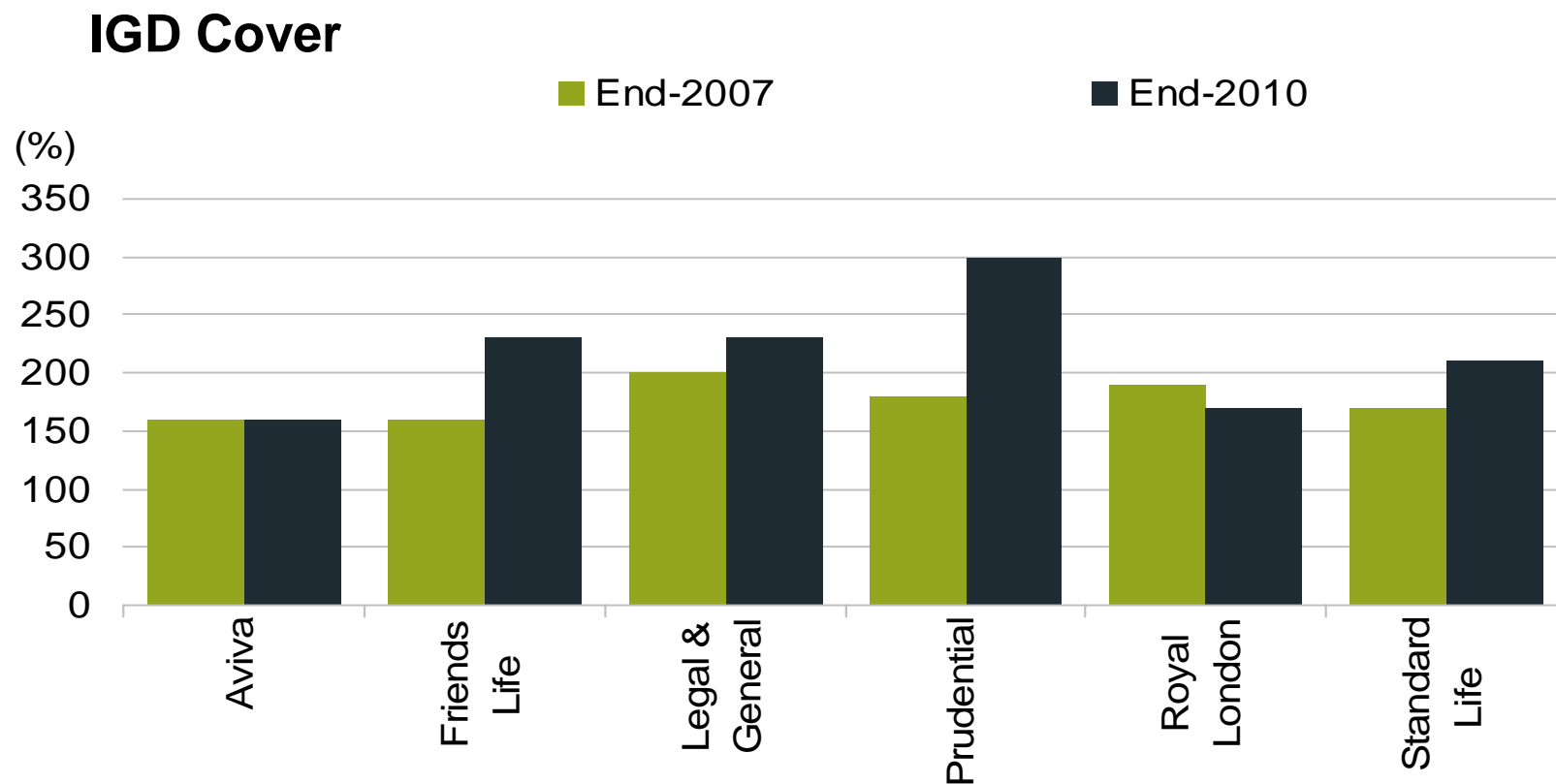
UK Life Market – Metrics

Capital Strong (1)



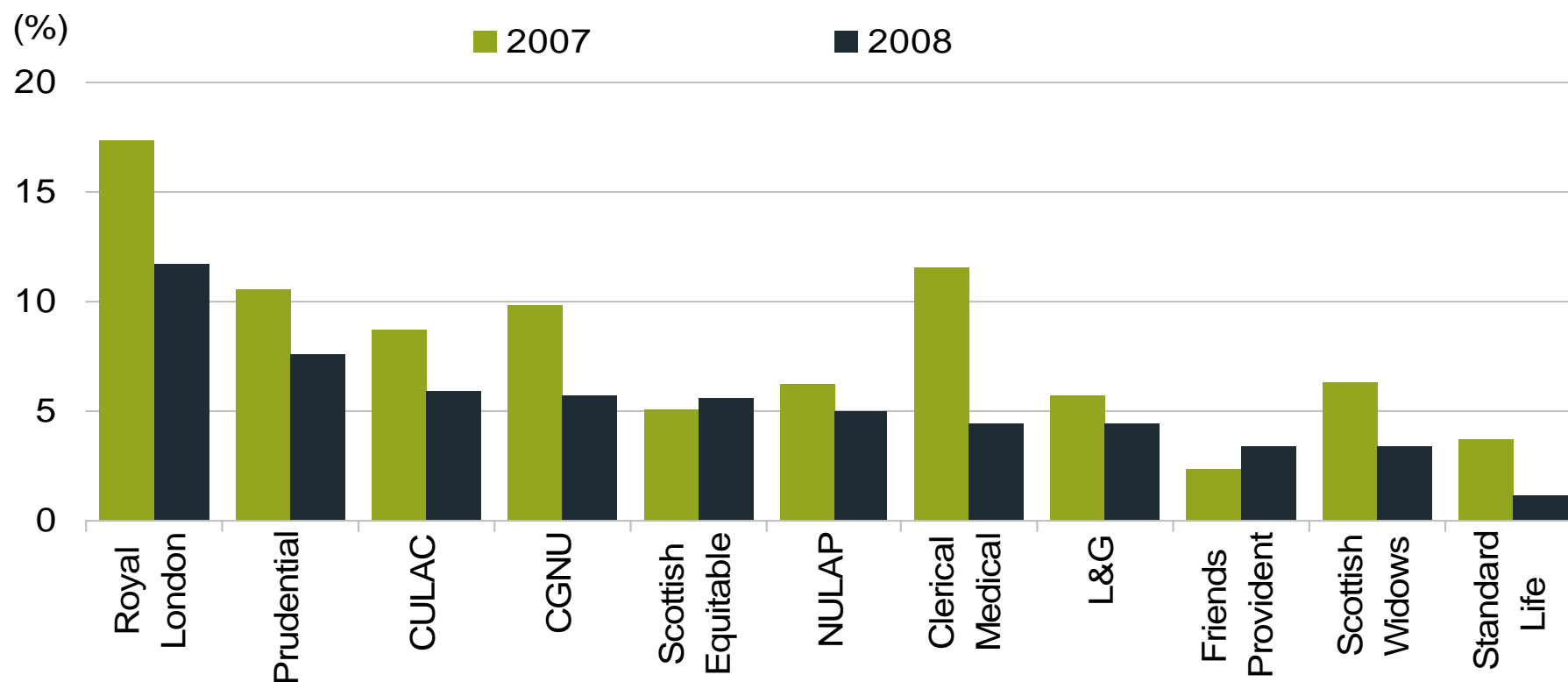
Source: Companies

Capital Strong (2)



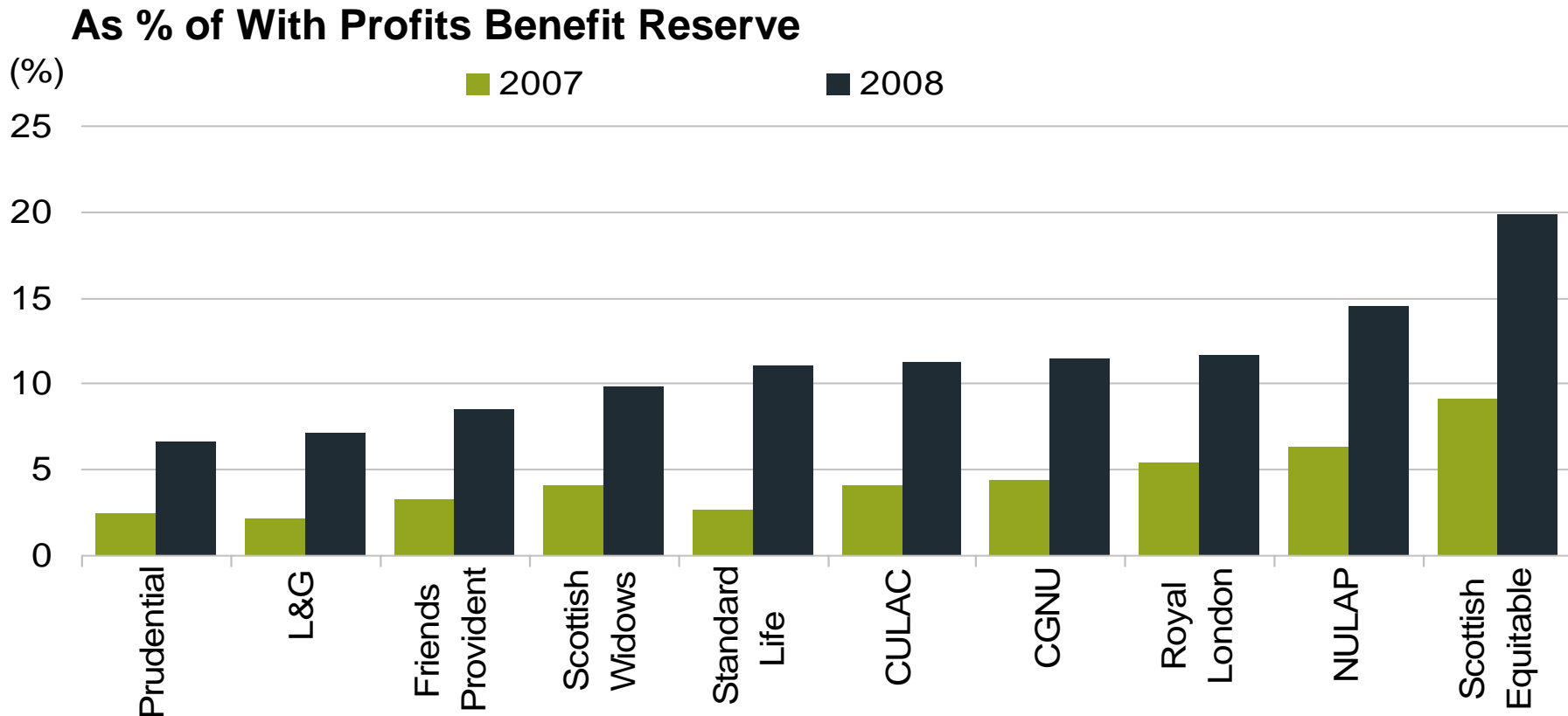
Source: Companies

WP Free Asset Ratios – Still a Risk



Source: Companies' FSA Returns, Fitch

WP Cost of Guarantees – Still a Risk



Source: Companies' FSA Returns, Fitch

Profits and Sales Under Threat

Threats to earnings:

- Low interest rates
- Defensive investments
- Net outflows

Threats to sales:

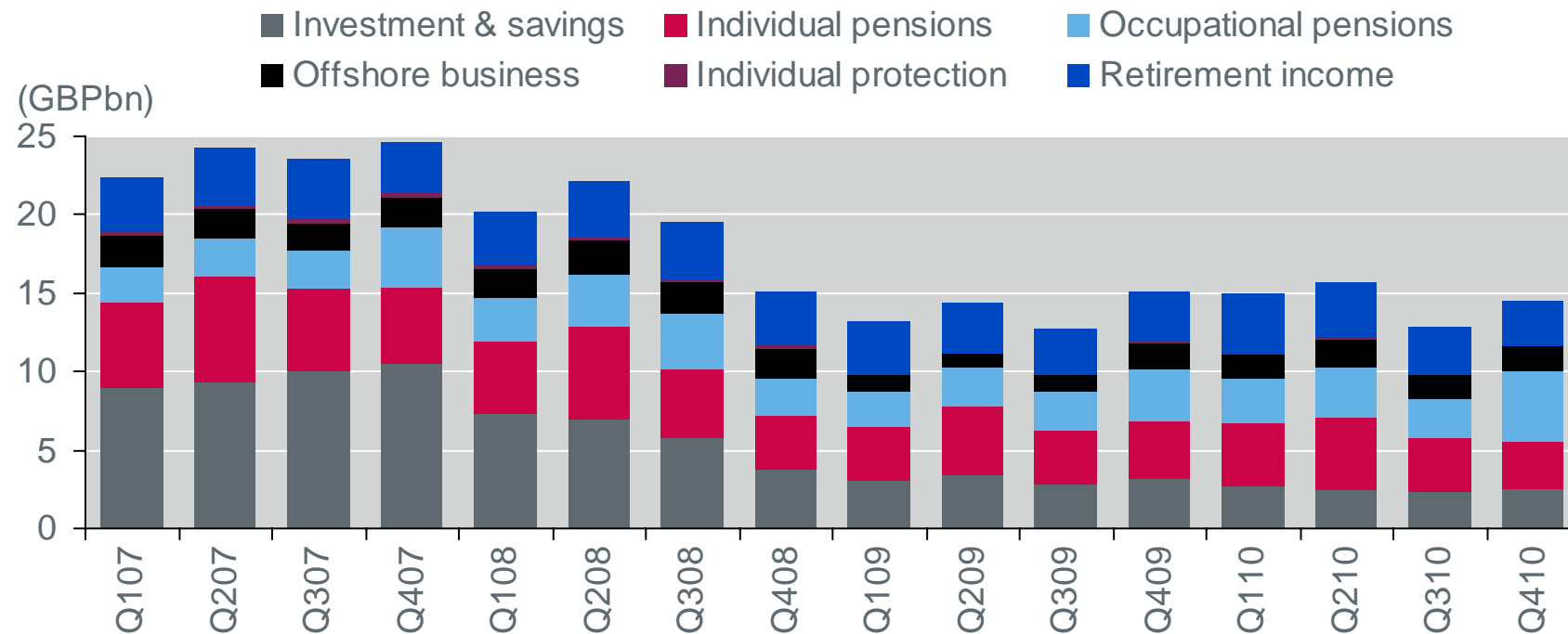
- Disposable income squeezed
- Consumer deleverage
- Slow housing market

Responses:

- Cost-cutting
- Low-cost distribution
- Consolidation
- Overseas earnings

Sales – Recovery Subdued

Quarterly Sales – Single Premium



Source: ABI

Earnings – EV and IFRS

- MCEV → Inconsistency
- EV in credit analysis
 - Long-term profitability (VIF, VNB)
 - Risks, profit drivers
 - Adjust IFRS balance sheet to allow for VIF
- I(?!)FRS ...
- EV for long-term value
- IFRS for group balance sheet and cashflow

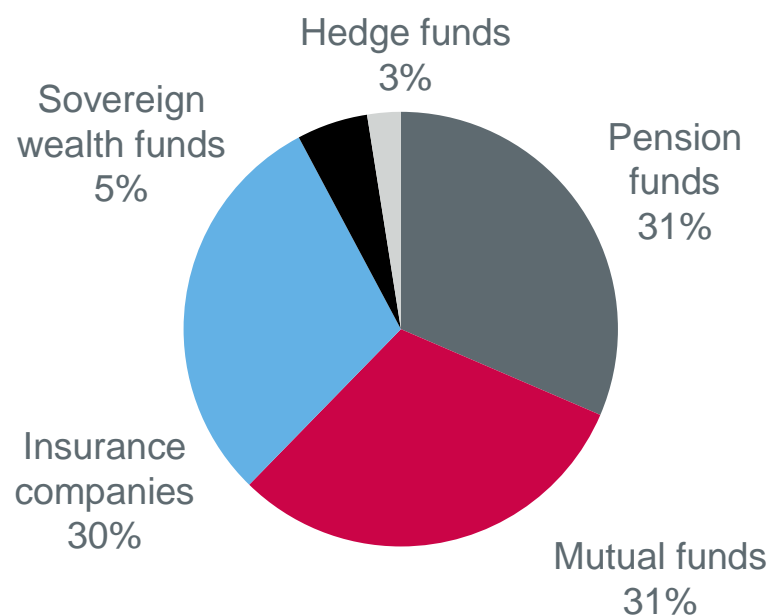
Agenda

Solvency II

The Global Investor Landscape

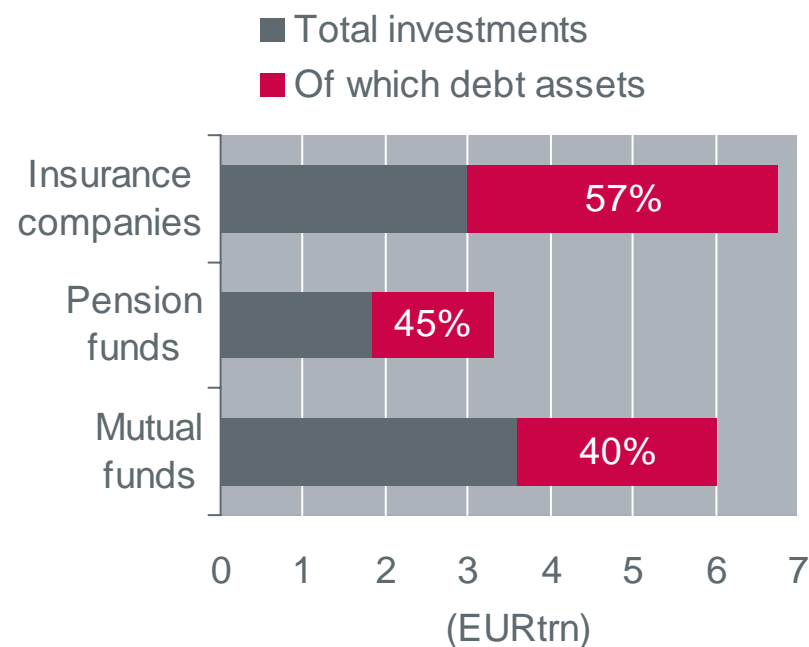
Global Investor Assets

EUR53trn



European Investor Assets

Total investments EUR16trn, o/w
EUR7.6trn in debt assets



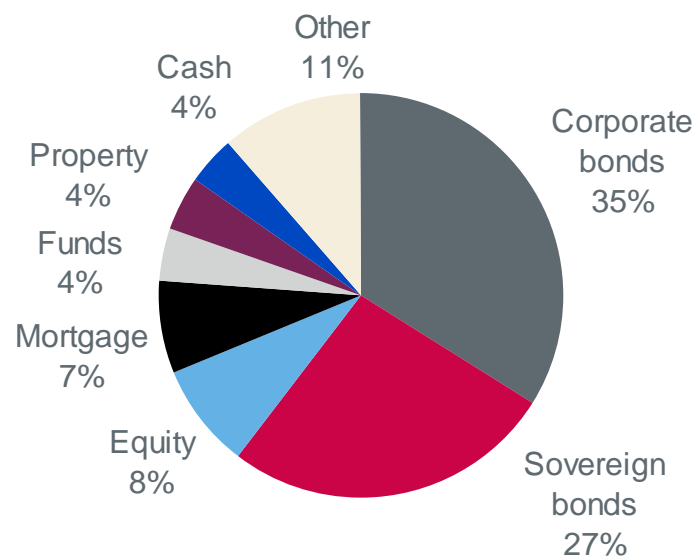
Source: Swiss Re, Fitch; CEA, OECD, Towers Watson, Mercer, EFAMA, ECB, Fitch

European Insurers Asset Allocation

EUR6.7trn

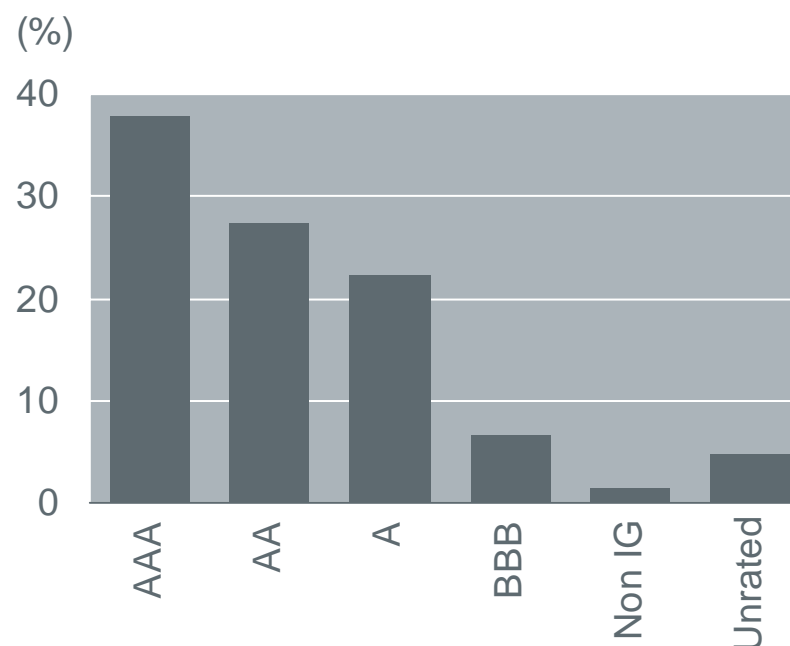
Asset Split

Excl. unit-linked, QIS 5 data, Groups



Insurers' Corporate Bond Holdings

QIS4 data, split by rating level

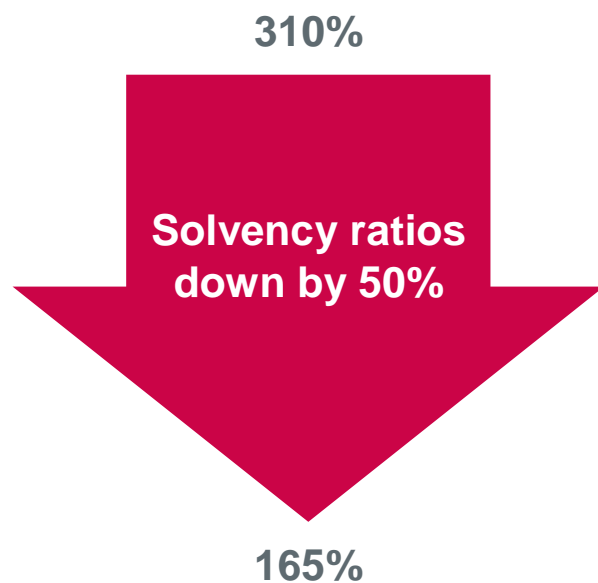


Source: Fitch, EIOPA

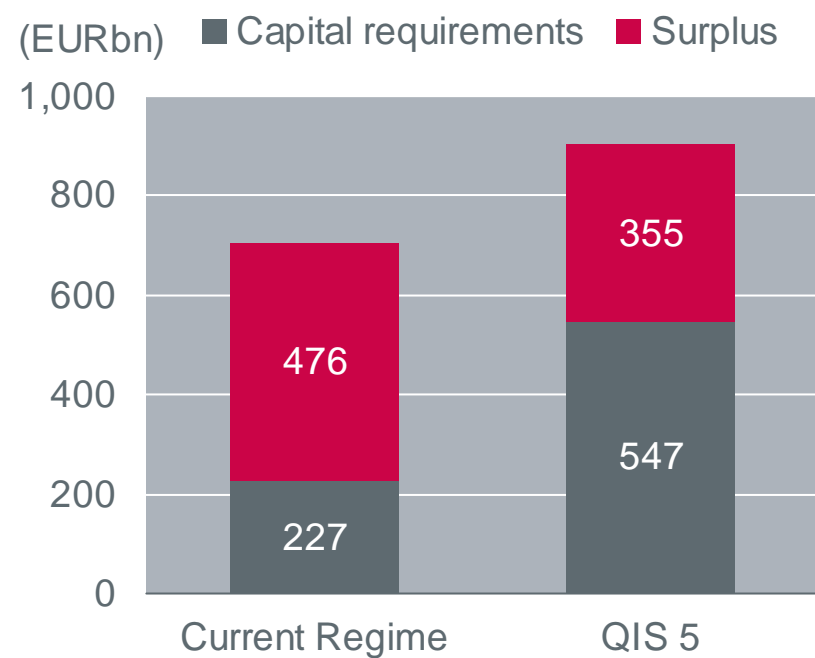
Where are Capital Positions Heading?

Using QIS5 as a guide

Solvency Ratio



Insurers' Capital Position



Source: Fitch, EIOPA

What Could Change the QIS5 Headline Figures?

Solo surplus reported of EUR355bn

- | | |
|---------------------------------------|------------------------------------|
| 1. Internal models and equivalence | • Euro <u>+83bn</u> at group level |
| 2. Expected profit in future premiums | • Euro <u>-84bn</u> Tier 1 |
| 3. Hybrid classification | • Euro <u>-82bn</u> at group level |
| 4. Restructuring | • Euro <u>+40bn</u> in the UK |
| 5. Transitional arrangements | • Euro <u>+xxbn ???</u> |
| 6. Draft charges | • Euro <u>+xxbn ???</u> |

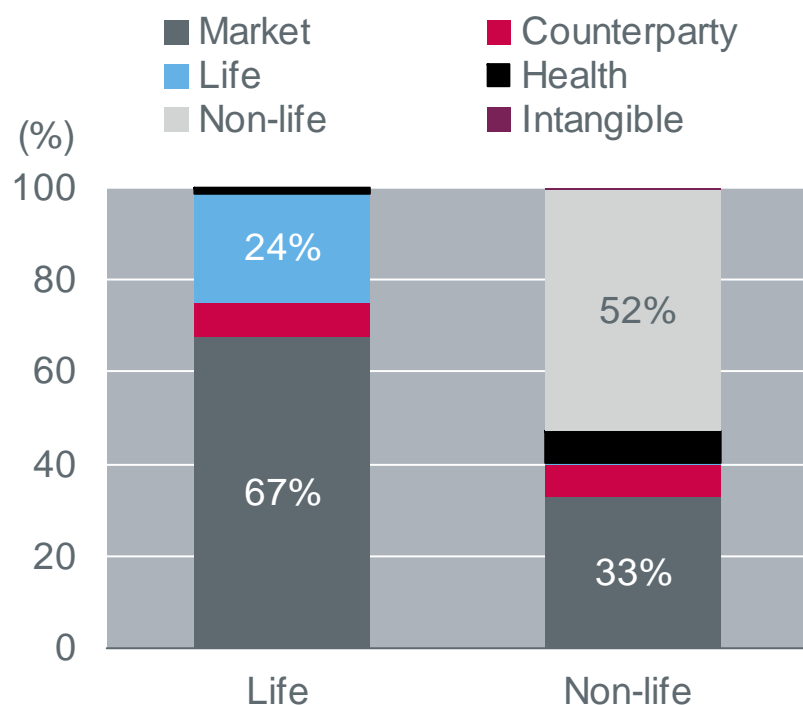
Surplus could halve or rocket depending on these outcomes

Source: Fitch, EIPOA

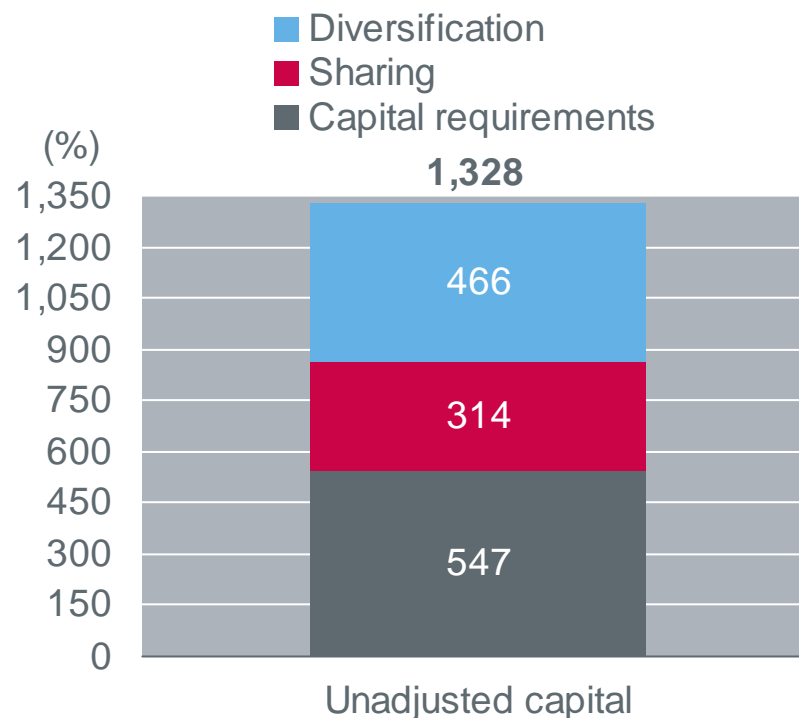
What Drives Capital Requirements Under Solvency II?

Market risk, diversification and sharing

QIS 5 Results Based on YE09 Data

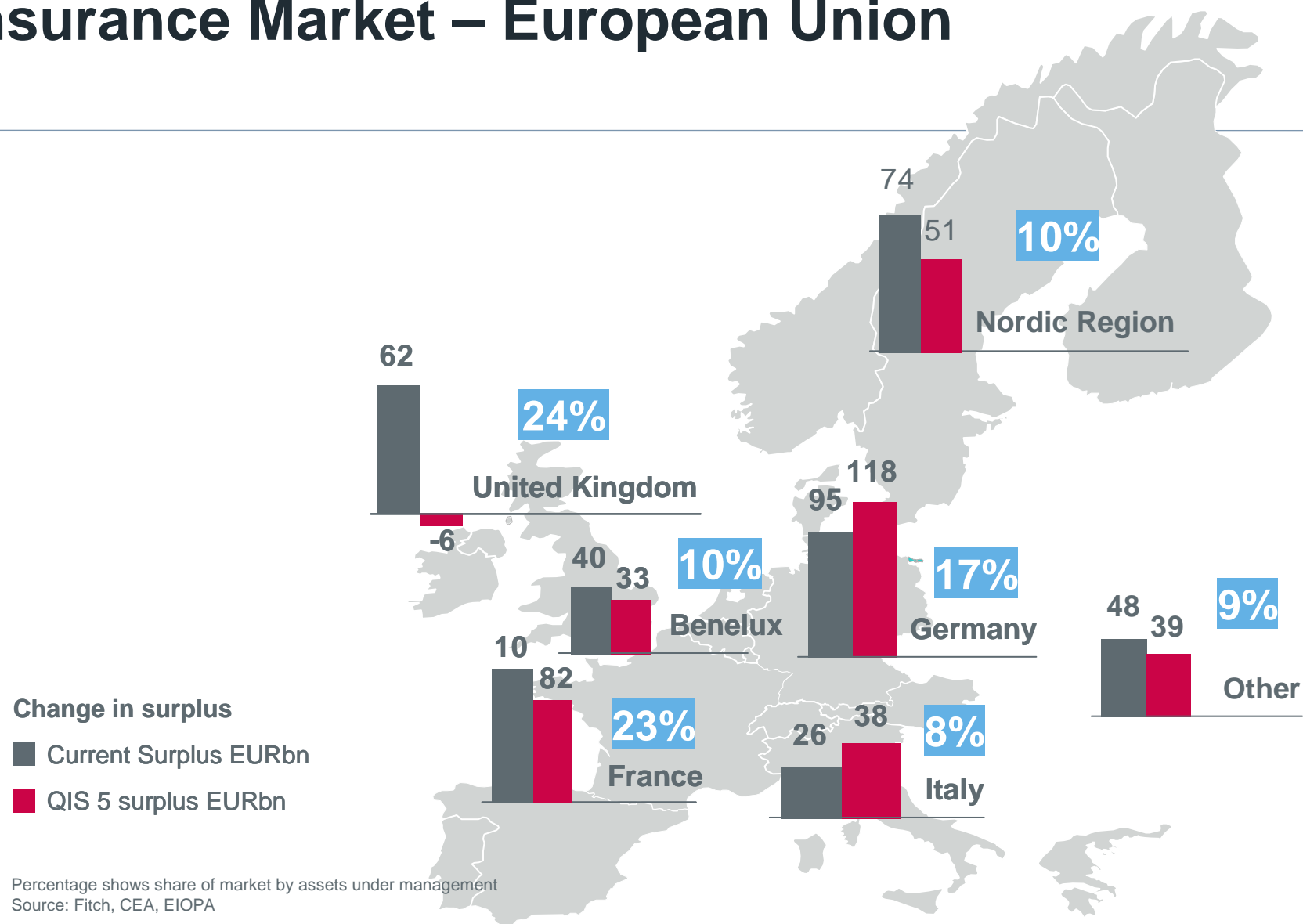


Diversification and Sharing



Source: Fitch, EIPOA

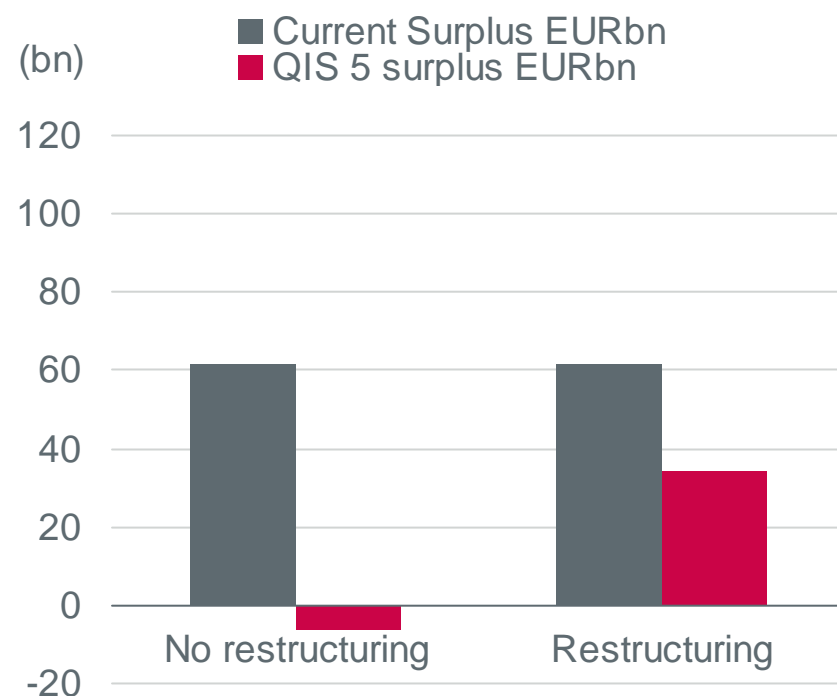
Insurance Market – European Union



The UK – 24% Market share

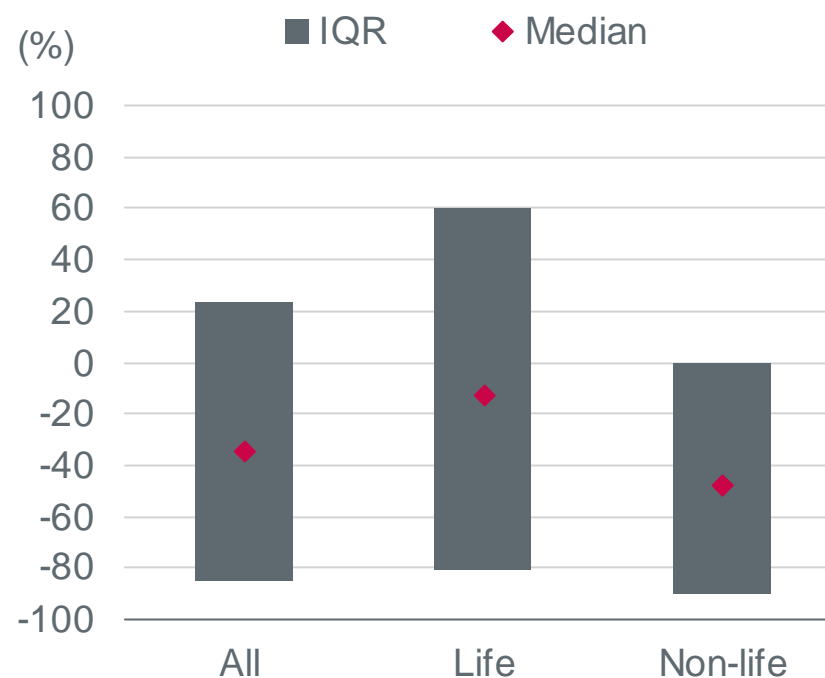
Capital ratio set to fall under Solvency II

The Impact of Restructuring



Source: Fitch, CEA, EIOPA

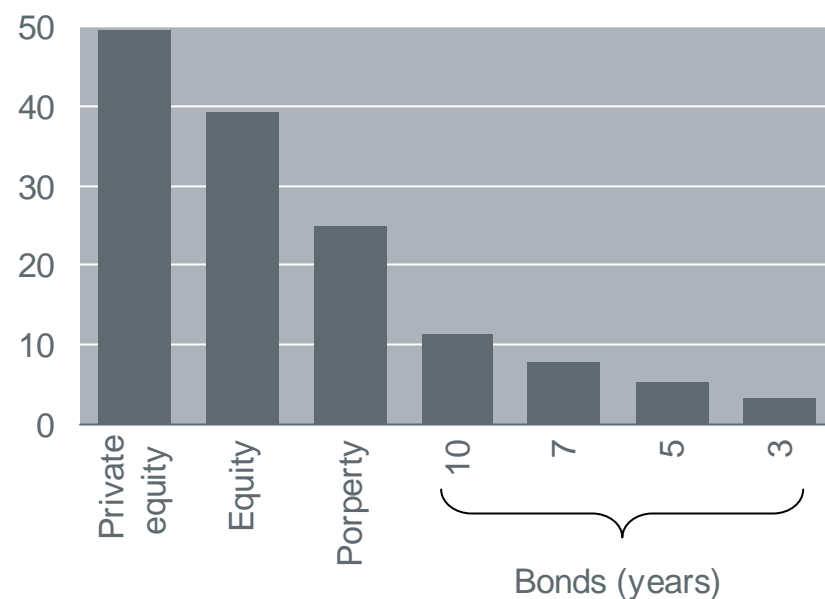
The Change in Surplus



Solvency II Brings in Asset Charges for Insurers

The Market Risk for the Insurance Sector Under New Capital Rules

Standalone standard capital charges by asset class (%)

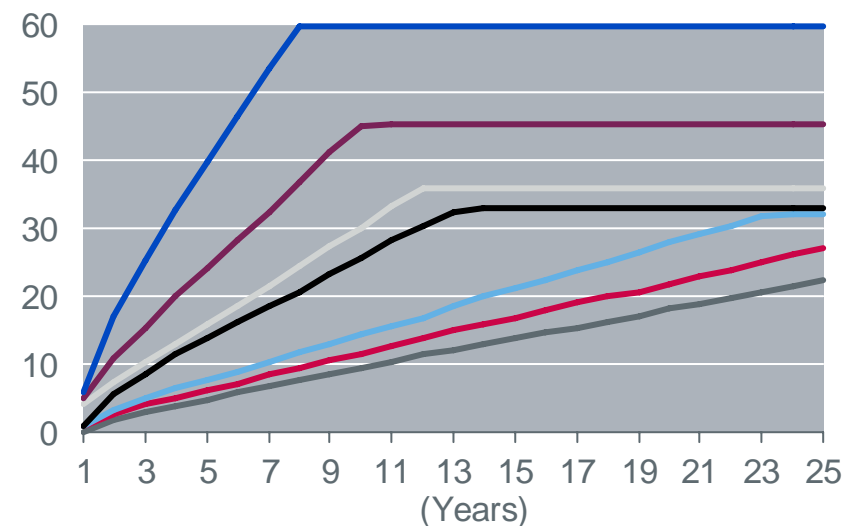


Source: Fitch, EIOPA

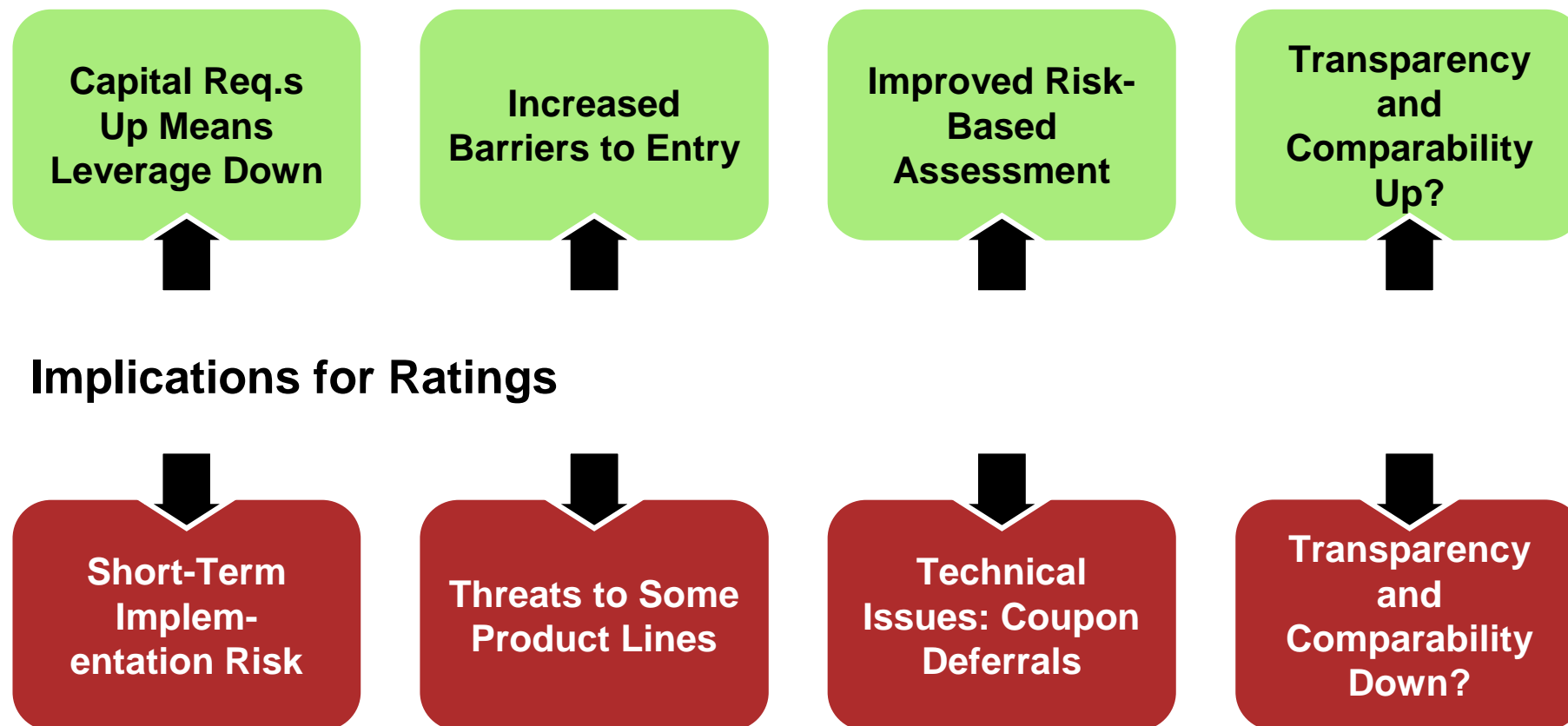
Corporate Bond Charges



Standalone standard capital charges by



Solvency II – Implications for Ratings

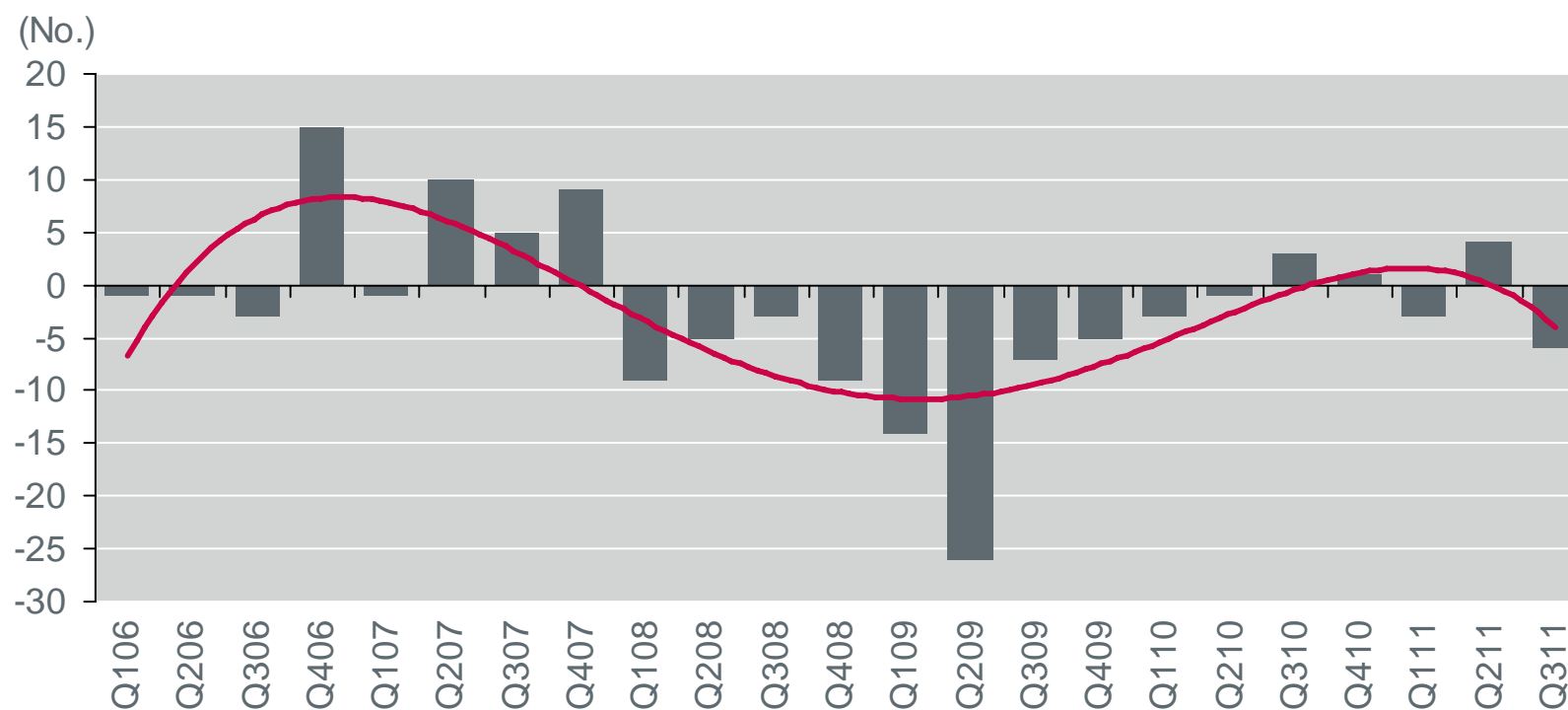


Agenda

Looking Ahead

Affirmations Predominate

Net Upgrades Less Downgrades



Source: Fitch

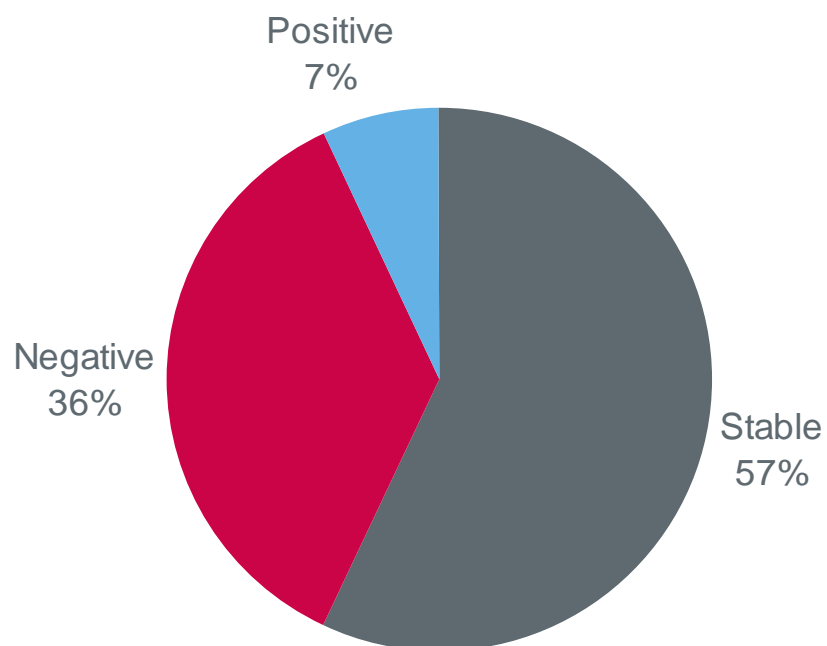
a

Sector Rating Outlook – Definition

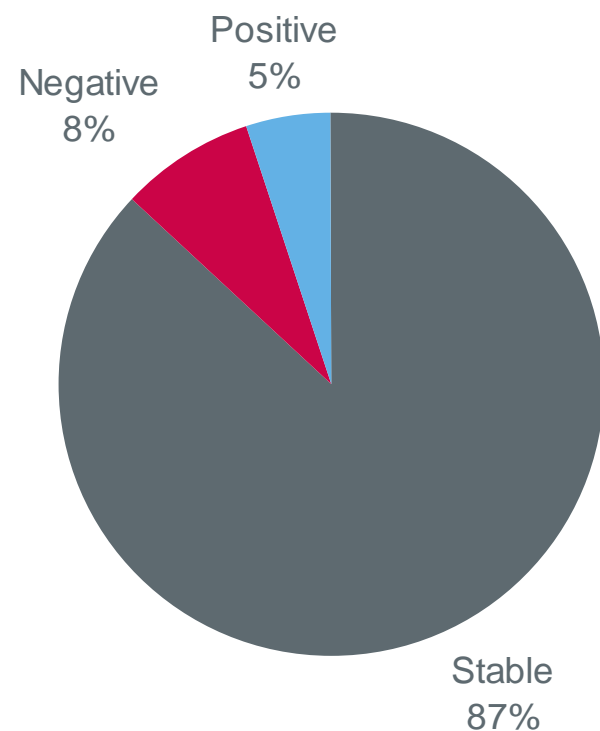
- Likely ratings direction (1-2 years)
- Not an indicator of fundamental trends already “in the ratings”
- Stable outlook
 - Most ratings will be affirmed ...
 - ...provided trends stay within Fitch’s expectations

Outlooks / Watches Show Stabilisation

A Year Ago...










Now...



Source: Fitch. Insurer Financial Strength ratings at 5 Oct 10 and 26 Sep 11

Market Credit Rating Outlooks – Mainly Stable

		Current	Since	Prior	Since
UK Life		Stable	Oct 10	Negative	Oct 08
UK Non-Life		Stable	Mar 10	Negative	Oct 08
German Life		Stable	Oct 10	Negative	Oct 07
German Non-Life		Stable	May 10	Negative	Oct 07
French Life		Negative	Sep 11	Stable	Oct 10
French Non-Life		Stable	Sep 11	Negative	Oct 08
Italian Life		Negative	Oct 11	Stable	Oct 10
Italian Non-Life		Negative	Oct 11	Stable	Mar 11
Netherlands Life		Stable	Sep 11	n.a.	n.a.
Netherlands Non-Life		Stable	Sep 11	n.a.	n.a.
Switzerland Life		Stable	Oct 10	Negative	Oct 08
Switzerland Non-Life		Stable	Oct 10	Negative	Oct 08
Reinsurance		Stable	Nov 09	Negative	Oct 08

Source: Fitch

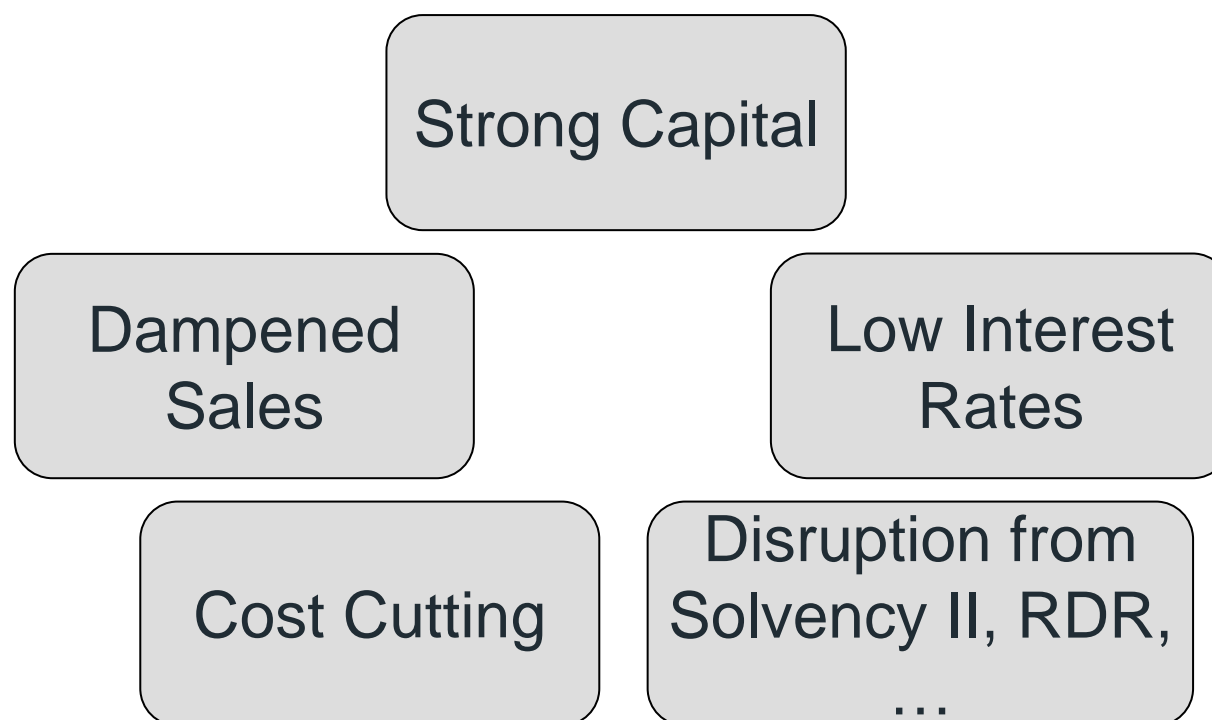
UK Life Ratings (21 November 2011)

Company	IFS rating ^a	Outlook/RW
Clerical Medical	A	Stable
Friends Life	A+	Stable
Legal & General	AA-	Stable
Old Mutual	A+	Stable
Prudential	AA	Stable
Standard Life	A	Stable
Scottish Widows	A	Stable

^a Insurer Financial Strength Rating of main operating company
Source: Fitch

UK Life Sector Rating Outlook = Stable

Fitch's expectations factored into ratings:



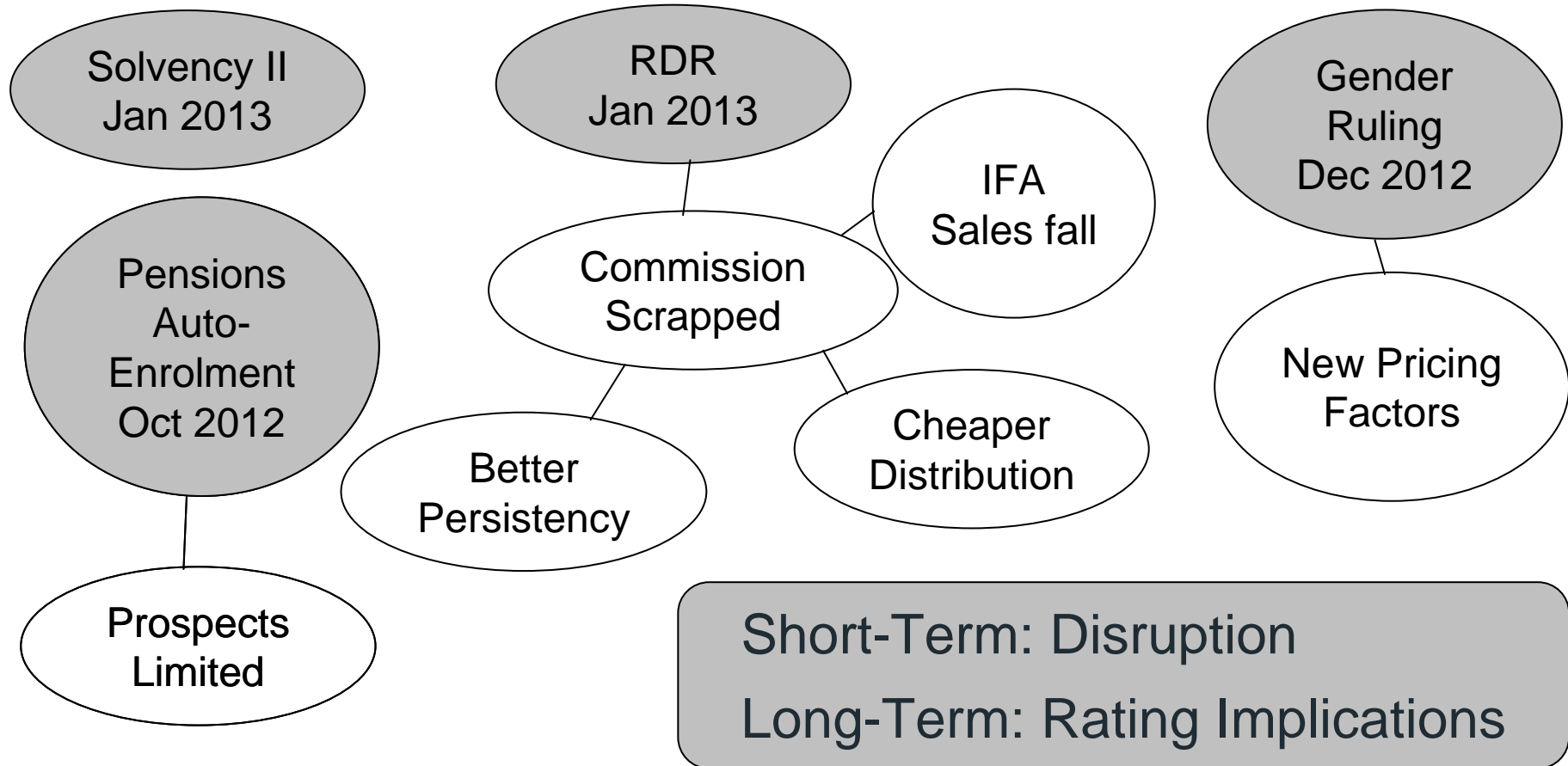
Top 10 Risks for Life Insurers



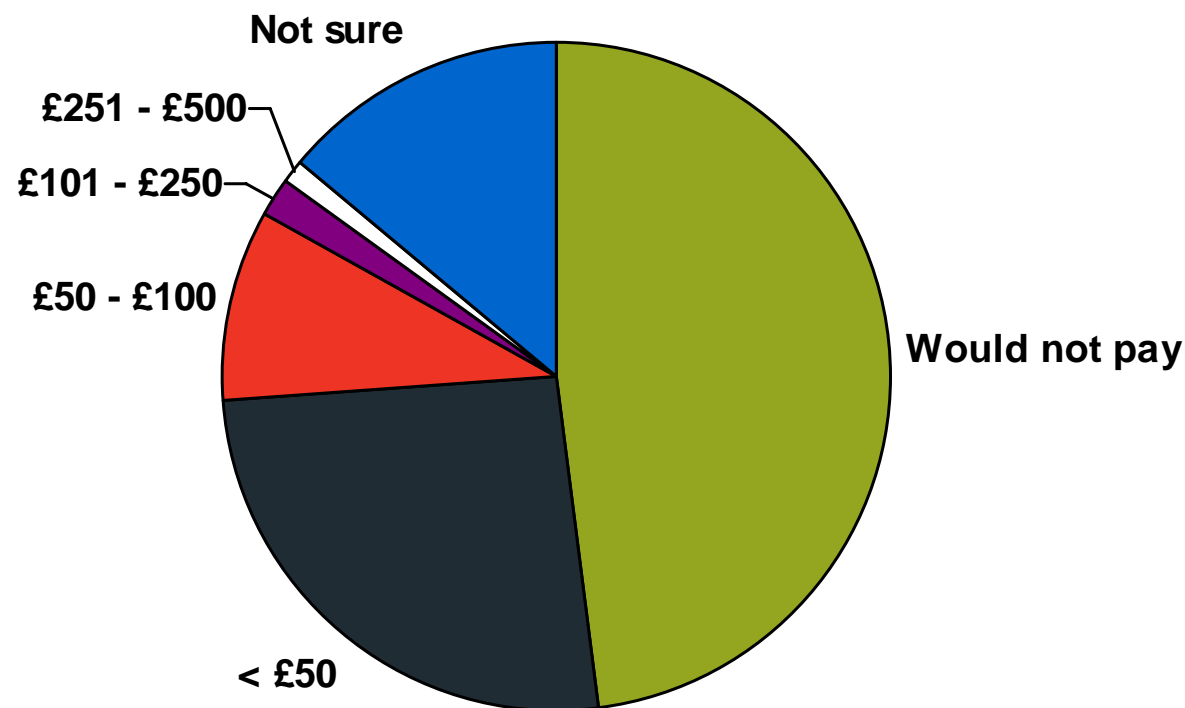
**Insurance
Banana Skins
2011** The CSFI survey of the
risks facing insurers

Rank	Risk
1	Regulation
2	Capital
3	Macro-economic trends
4	Distribution channels
5	Investment performance
6	Managing costs
7	Interest rates
8	Talent
9	Retail sales practices
10	Reputation

This Time Next Year ...

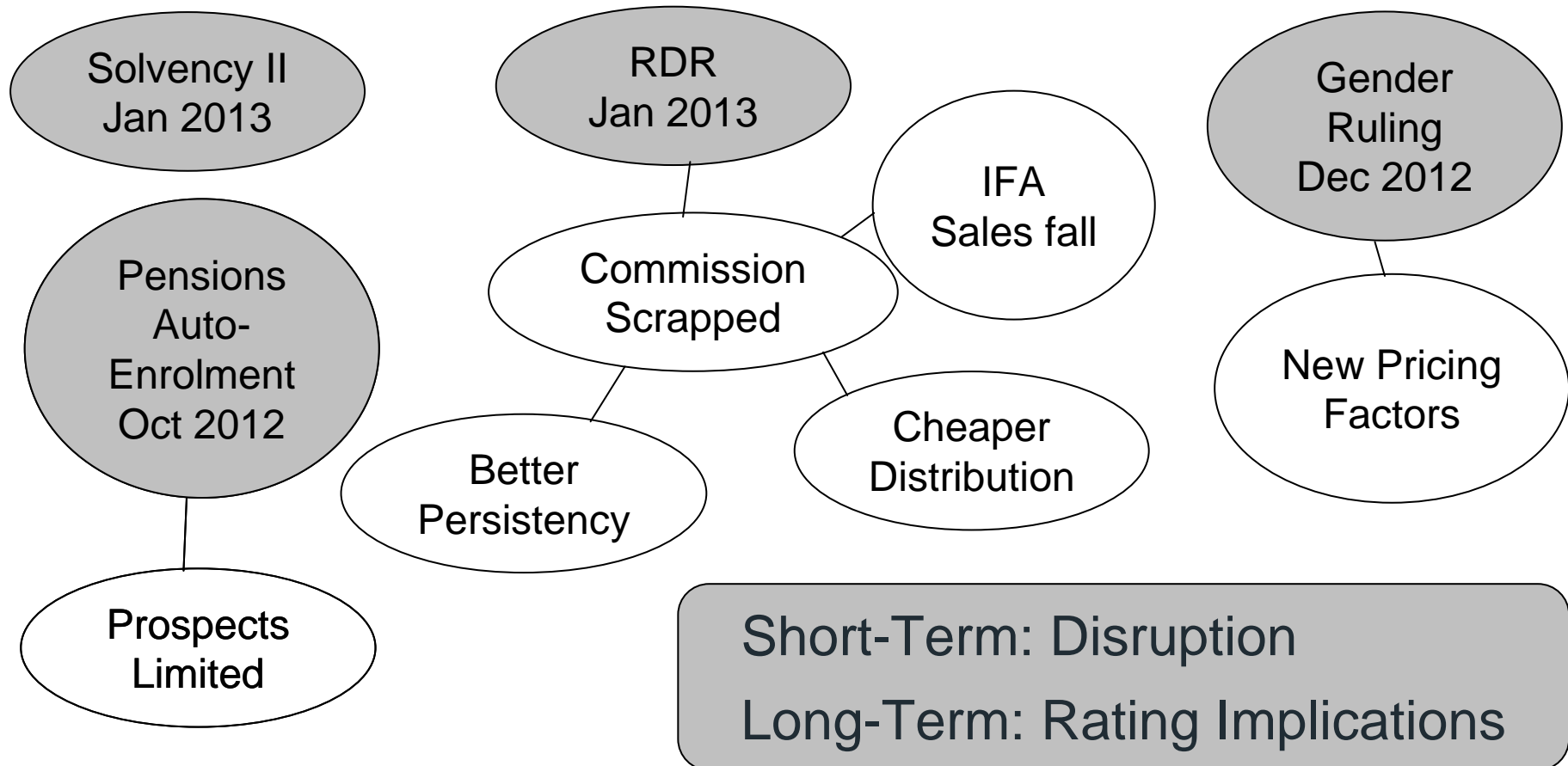


RDR ... “If you were required to pay a fee for advice, how much would you be willing to pay?”



Source: ABI Quarterly Consumer Survey Q3 2011

This Time Next Year ...



Predictions for 2012+

- Distribution
 - IFA sales fall
 - Bancassurance / direct sales rise
- Products
 - Savings get simpler
- Regulatory / financial reporting
 - Solvency II gets (more) political
 - MCEV remains on hold
 - IFRS Phase 2 heralds (more) confusion
 - M&A sparked by low margins, Solvency II, war chests

What Insurers May Not Want You to Know

- The whole truth
 - Headlines always good
 - Operating / underlying
 - “Good results = good management, bad results = markets”
 - Modelling “adjustments”
- Lapses / surrenders / outflows – hidden behind sales figures
- Sensitivity to credit markets
- Solvency II
 - Not ready
 - Worst-case impacts
- Capital / M&A strategy (“delighted to have sold our acquisition”)
- They are insurers (“de-risked our balance sheet”)

Solvency II – Some Things We’ve Heard This Year

- *“FSA estimates Solvency II will cost the UK industry £1.9bn”*
- *“Doing away with risk would kill our business. It is the business!”*
- EIOPA:
 - *“Capital is like a husband; my wife expects me to be there only when she really needs me!”*
 - *“Full market-consistent is the worst of all the systems, except for all the other ones”*
- CFO Forum, CRO Forum, CEA, PEIF:
 - *“Stakes are high and time is running out”*

Solvency II – More Things We’ve Heard This Year

- Various CROs (all from market-leading insurers):
 - *“Don’t kill the patient while operating on him”*
 - *“The way to kill an industry is to make it unprofitable”*
 - *“Our main risk is that the regulator is too short-staffed to approve us”*
 - *“Trying to prepare for Solvency II is like trying to nail jelly to the ceiling”*



Q&A?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

