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Life Insurance & the ‘New Normal’

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Charles Garnsworthy

PwC LLP

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Presenters

Dr. Andrew Sentance CBE

- Senior External Advisor to PwC
- Served on the Bank of England Monetary Policy Committee from 2006 to 2011.
- Founder member of the Treasury's Panel of Independent Forecasters - also known as the "seven wise men"

Charles Garnsworthy

- PwC's Actuarial Leader – leading a team of over 260 people across five locations across the U.K. and India
- Leader of PwC's Solvency II multi-disciplinary team
- Reviewing Actuary for a number of major UK insurance groups.

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Agenda

1. What is the “New Normal”?
2. Table discussion groups
3. Opportunities and challenges for Life Insurers in the “New Normal”

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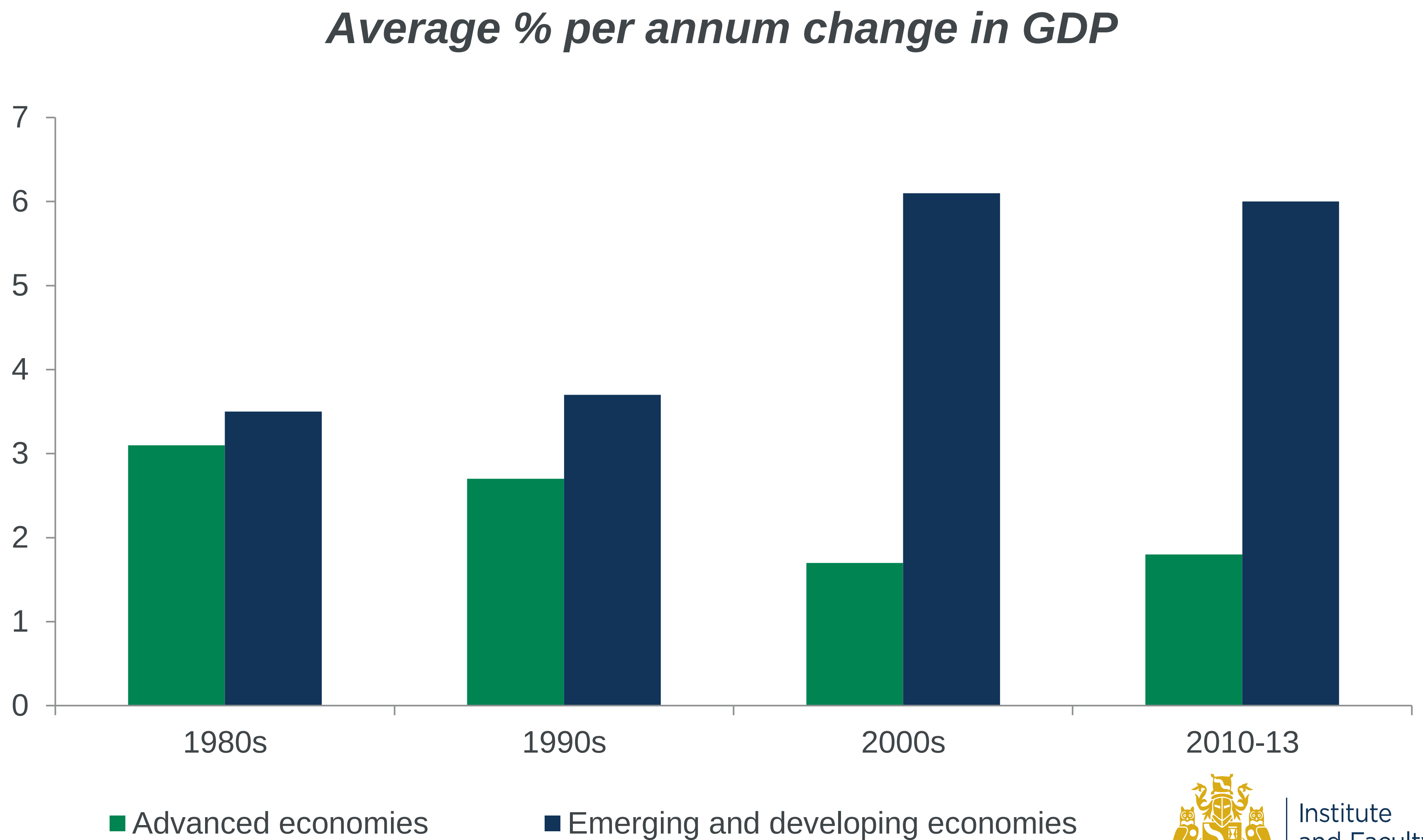
What is the New Normal?

The changing pattern of global growth



Source: IMF World Economic Outlook

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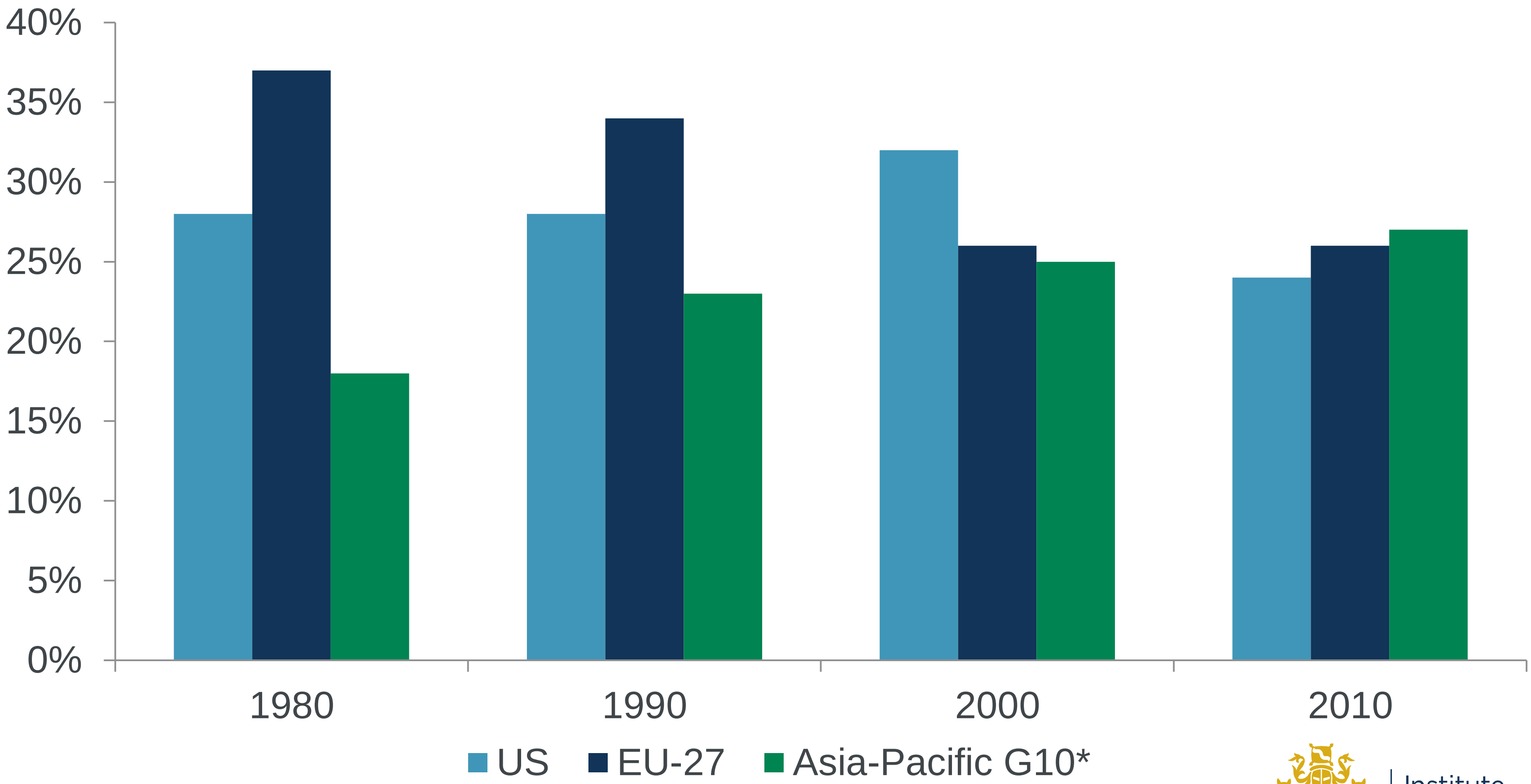
Asia-Pacific now the dominant region

% share of world GDP – current market prices and exchange rates



Source: IMF World Economic Outlook

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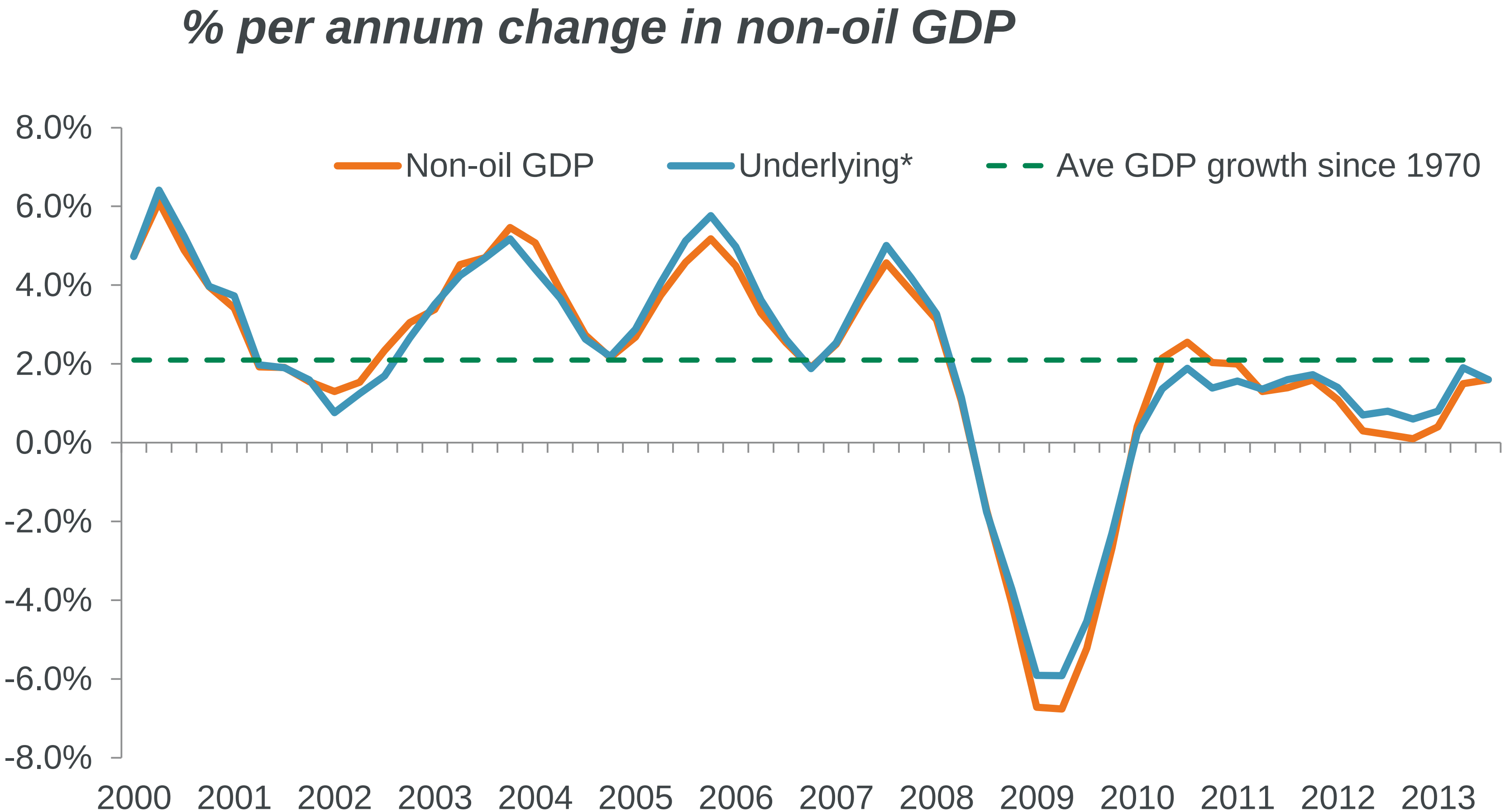
UK economic growth has disappointed



** Weighted average of manufacturing and services growth*

Note: Average non-oil GDP growth since mid-2009 = 1.3%

Source - ONS

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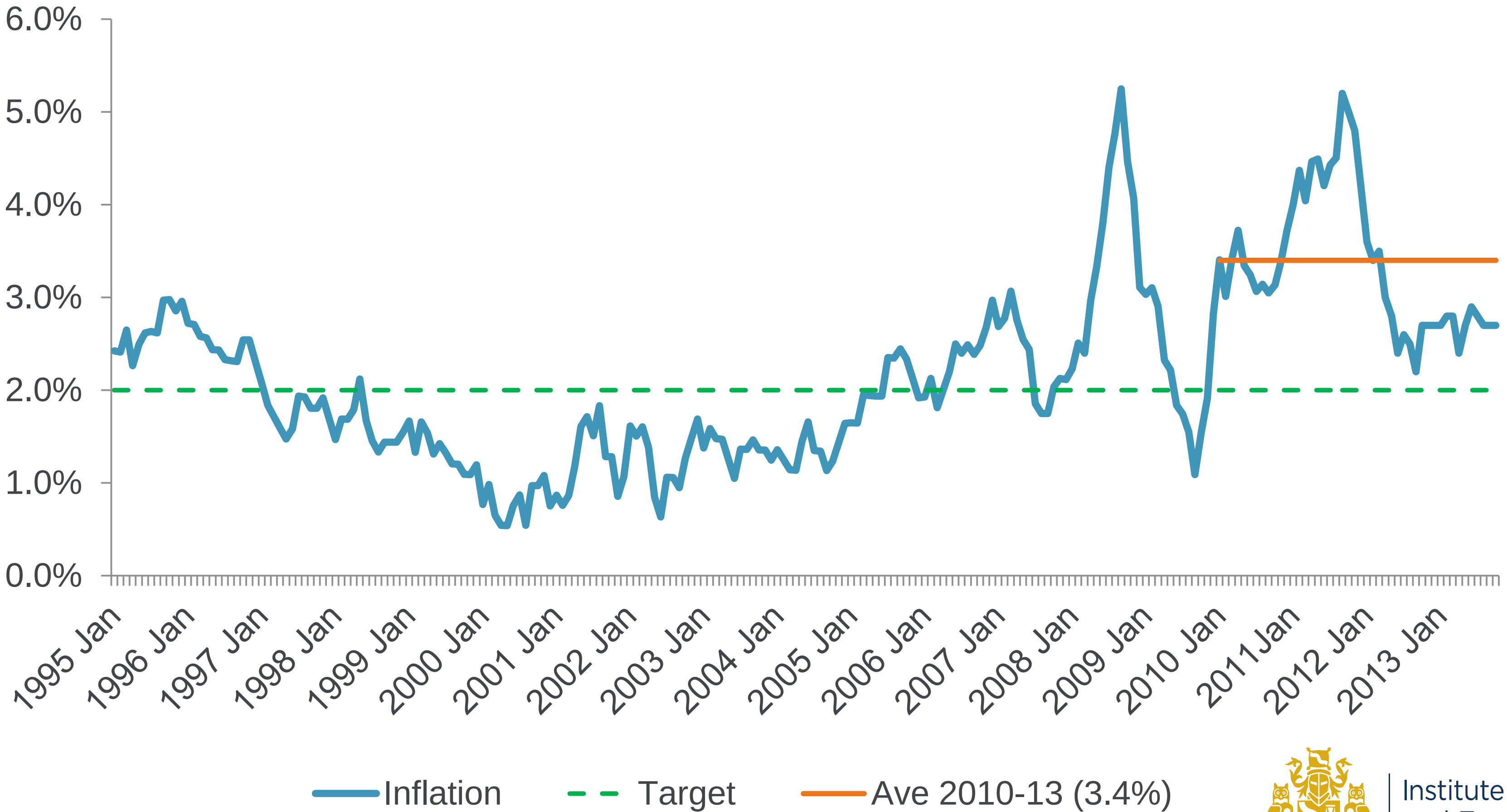
… and inflation persistently above target

% per annum increase in UK consumer prices



Source: Office for National Statistics

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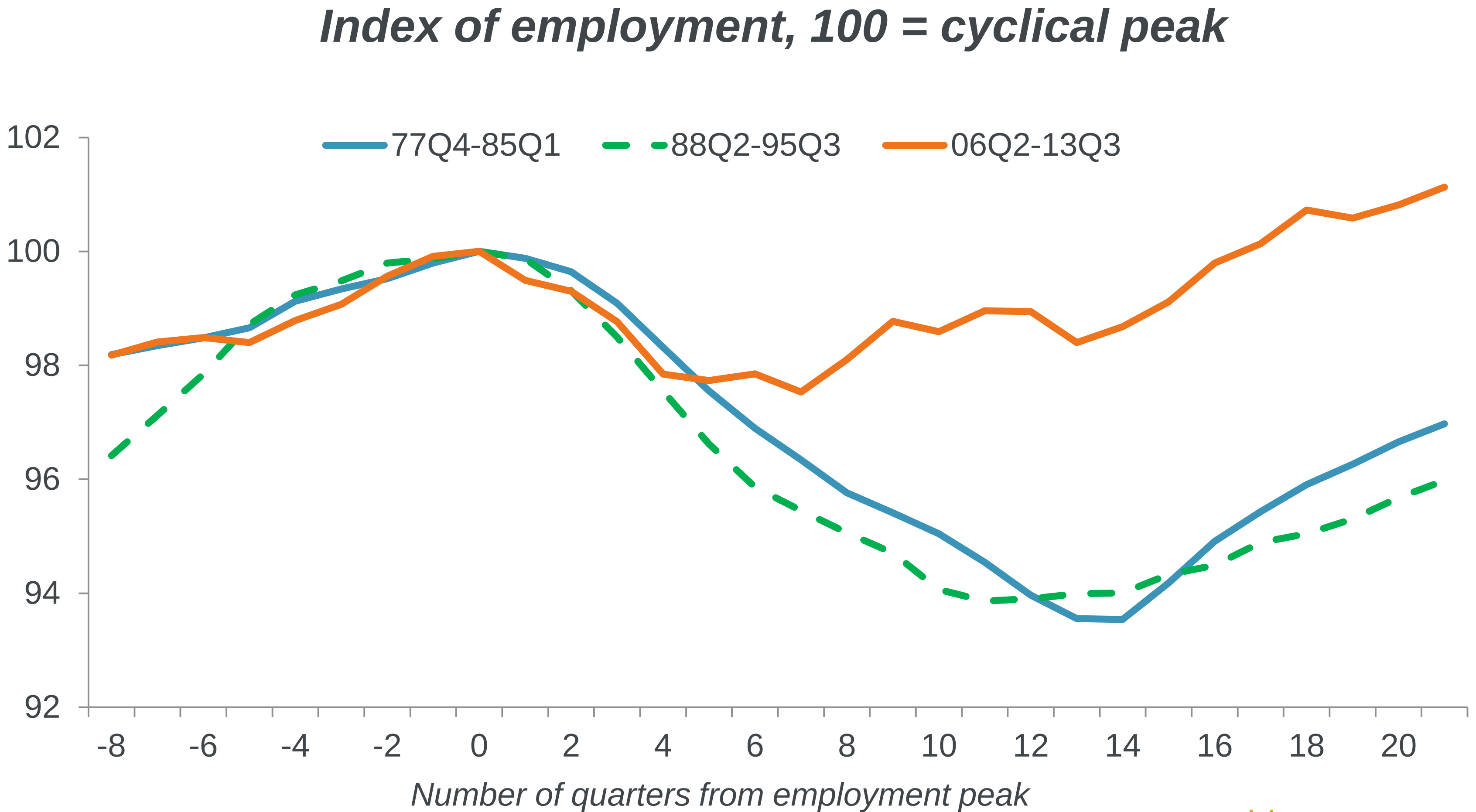
… but employment has been resilient



Note: Private sector employment has risen by about 1.5m (6.6%) since beginning of 2010

Source: Office for National Statistics, Labour Force Survey

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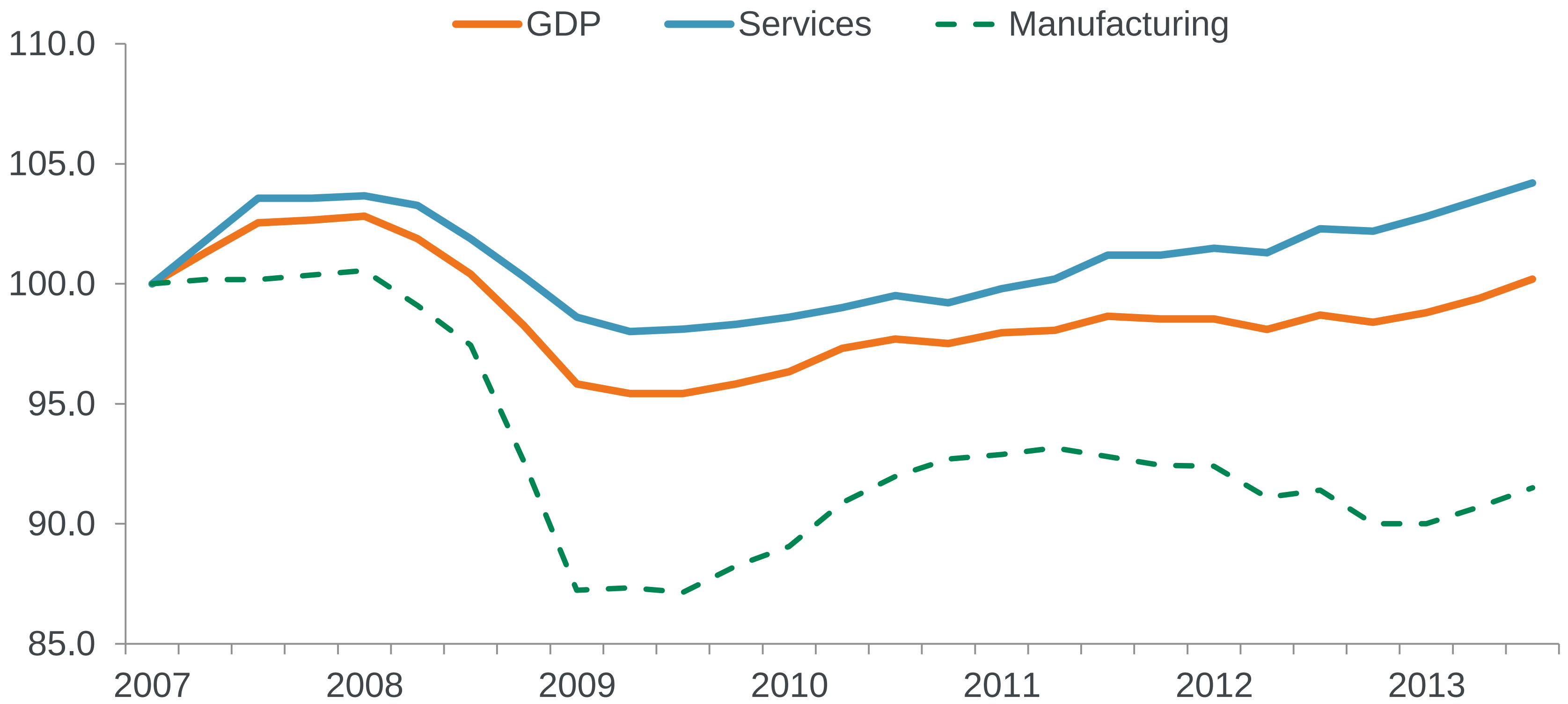
Services are driving the UK recovery

Indices of UK output, 2007Q1 = 100



Source - ONS

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What is the "New Normal"?

2007/8 marked the end of a long and sustained expansion in UK and other Western economies

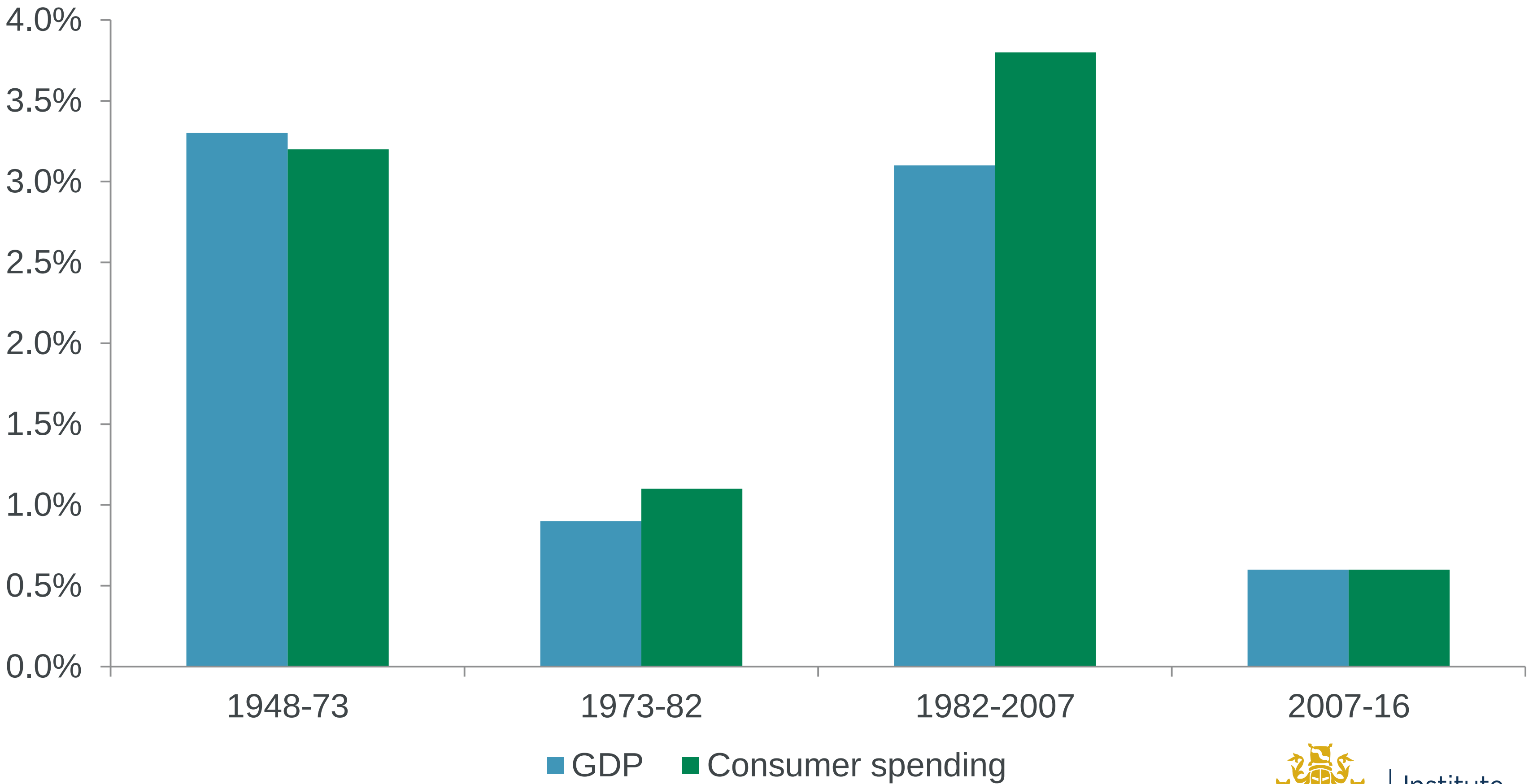
Conditions which supported this period of growth are not set to return quickly

Prolonged structural readjustment is underway in response to financial crisis and East-West rebalancing

There are significant parallels with disappointing growth and volatility of the 1970s and early 1980s

Long expansions and their aftermath

Average % per annum change in UK GDP and consumer spending



Source: ONS, PwC and OBR Forecasts

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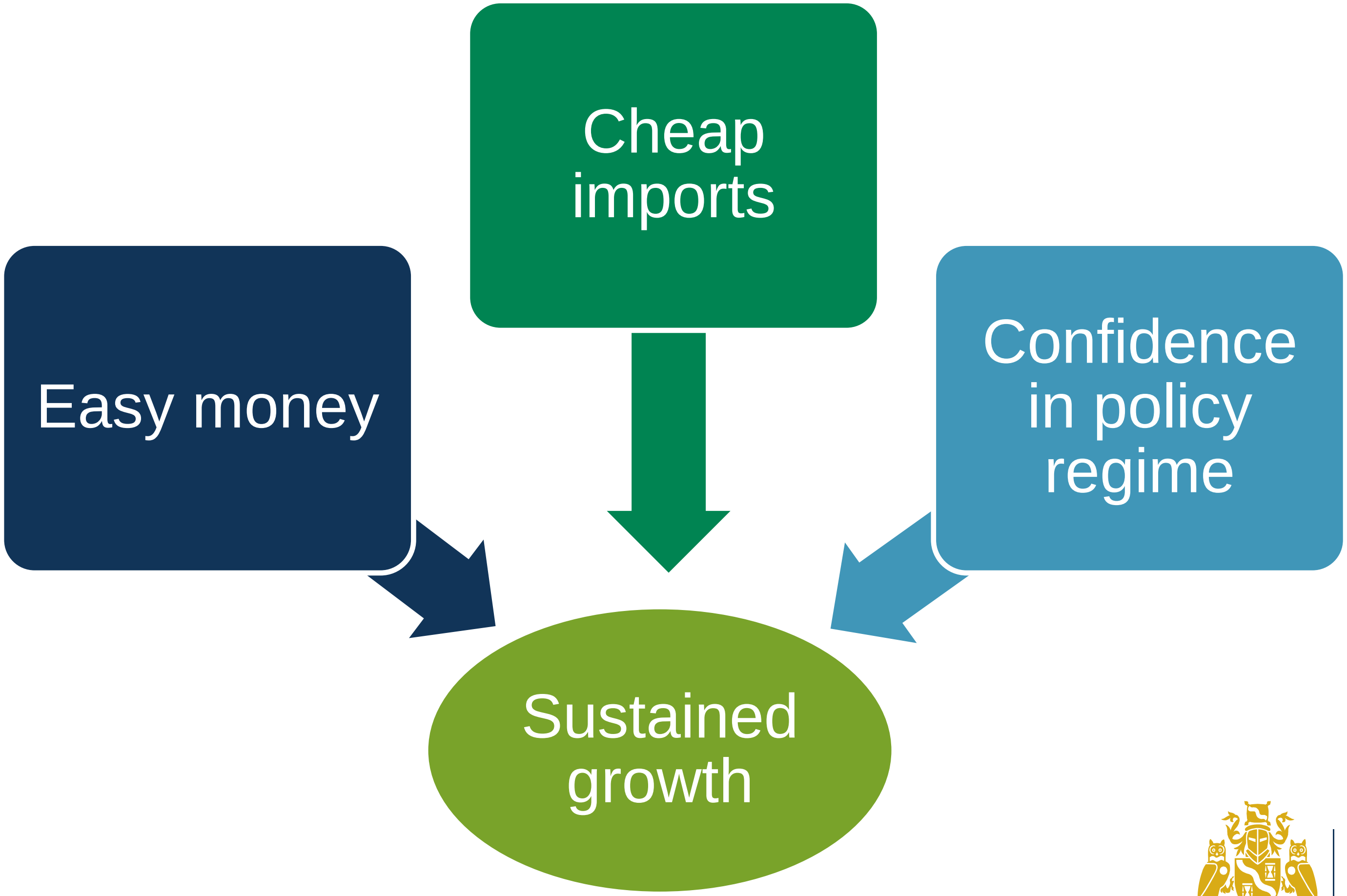
Pre-2007 growth drivers have disappeared



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Two phases of the “New Normal”

Current Phase

- Disappointing western growth to continue through mid-2010s
- Financial volatility persists
- High and fluctuating energy and commodity prices

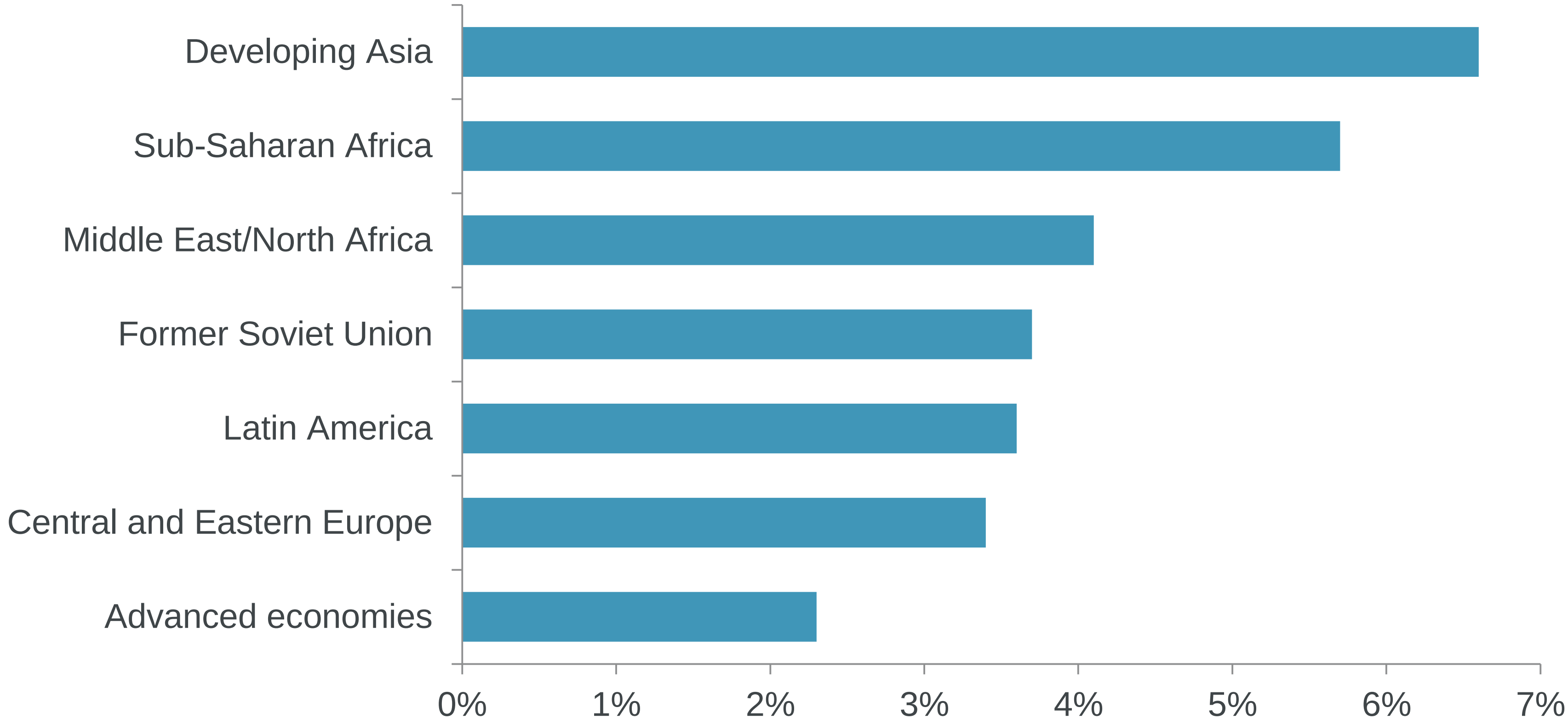
New Growth Phase?

- Clearer and more sustained growth dynamic emerges
- Perhaps starting in the second half of this decade
- Different set of growth drivers from pre-2007 long expansion

Businesses, policy-makers and investors need strategies to manage and survive through current disappointing growth, while building potential opportunities for the future.

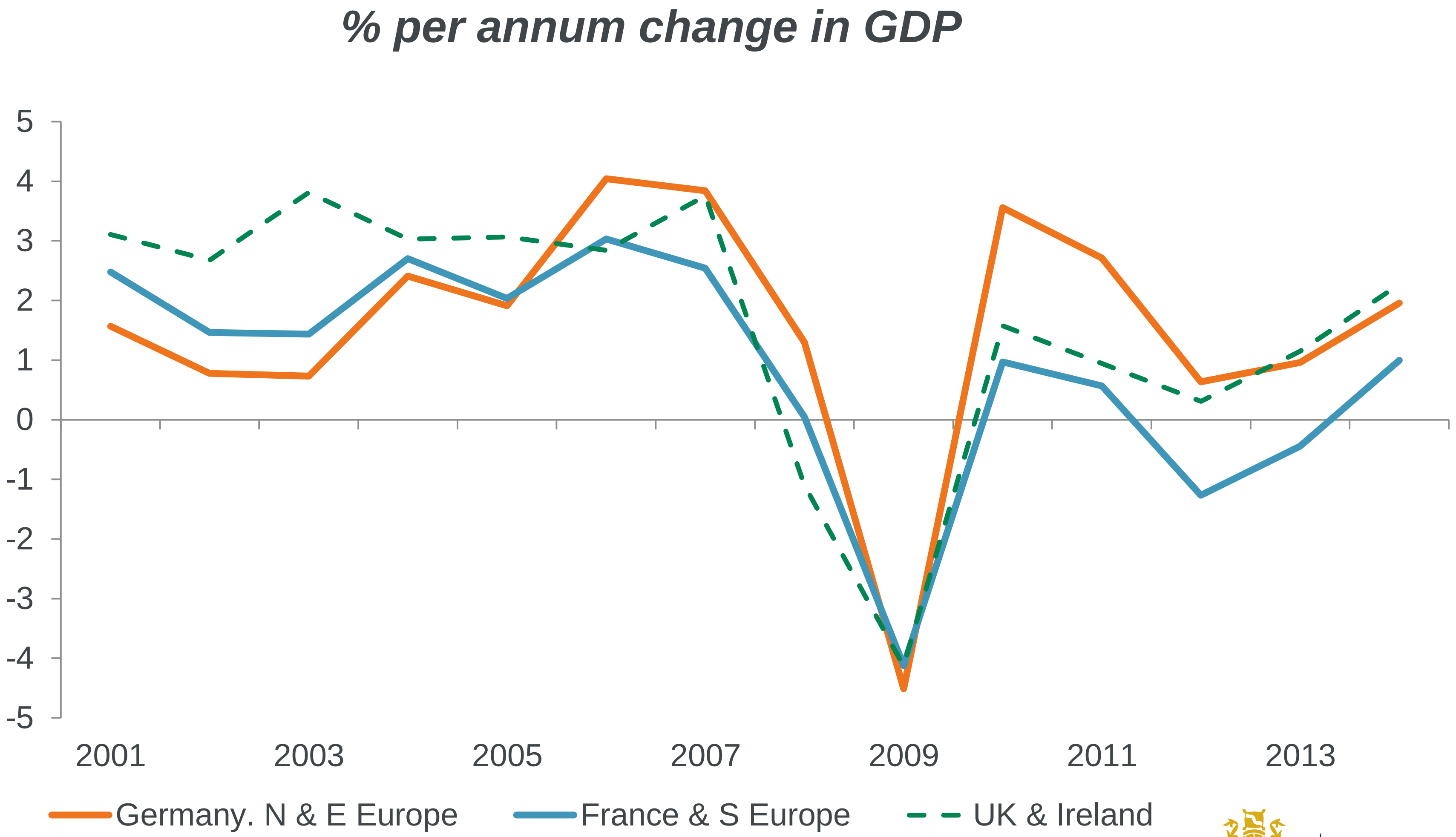
Emerging markets still outpacing the West

% average growth, 2014-18, latest IMF forecasts



Source: IMF World Economic Outlook

Two-speed European economy persists



Source: Eurostat and European Commission forecasts

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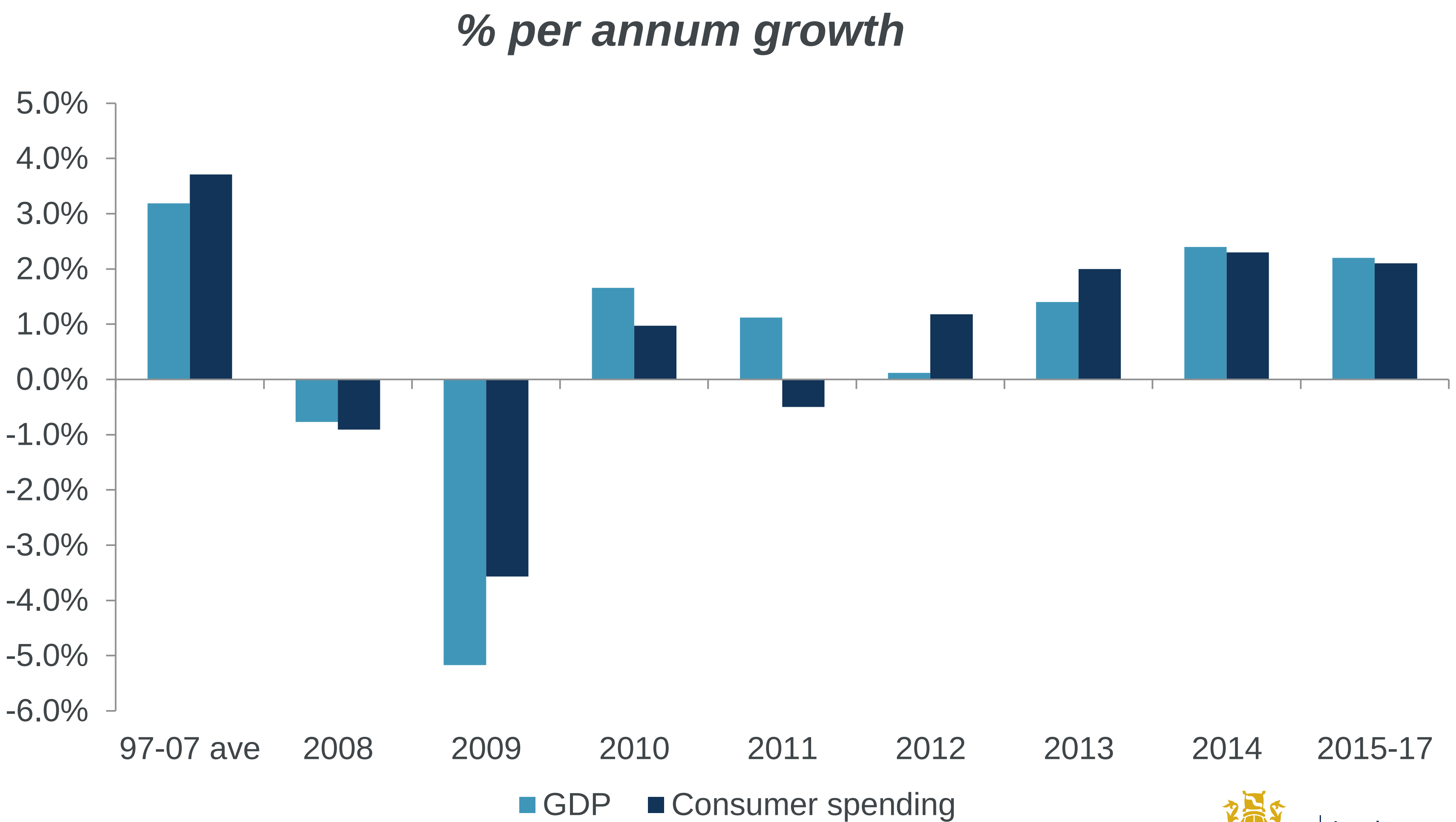
UK GDP and consumer outlook



Source: ONS, PwC and HM Treasury Review of Independent Forecasts

Investment climate in the “New Normal” economy

- “New Normal” implies subdued growth and investment returns for next 3-5 years
- BUT longer term planning needs to keep an open view on the prospect of transition to a “New Growth Phase” for better adapted western economies
- UK inflation relatively high – “wrong sort of inflation” driven by global price shocks and currency depreciation
- Interest rates should stay low, though likely to rise gradually as the decade progresses and growth prospects improve
- Investments in well-run international companies can help tap into growth in Asia and other EM economies

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Opportunities and challenges for Life Insurers in the "New Normal"

Insurance CEO/CFO/CROs concerns

Top 10 risks facing insurers

1. Regulation
2. Investment performance
3. Macro-economic environment
4. Business practices
5. Natural catastrophes
6. Guaranteed products
7. Quality of risk management
8. Quality of management
9. Long-tail liabilities
10. Political interference

These concerns are all directly related to the “New Normal”

Source: PwC Insurance Banana Skins 2013

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Discussion

In the context of the "New Normal"…

What do you see as the potential challenges your organisation faces?

How is your organisation positioned to deal with these challenges?

What are the ways in which your organisation can differentiate itself to succeed?

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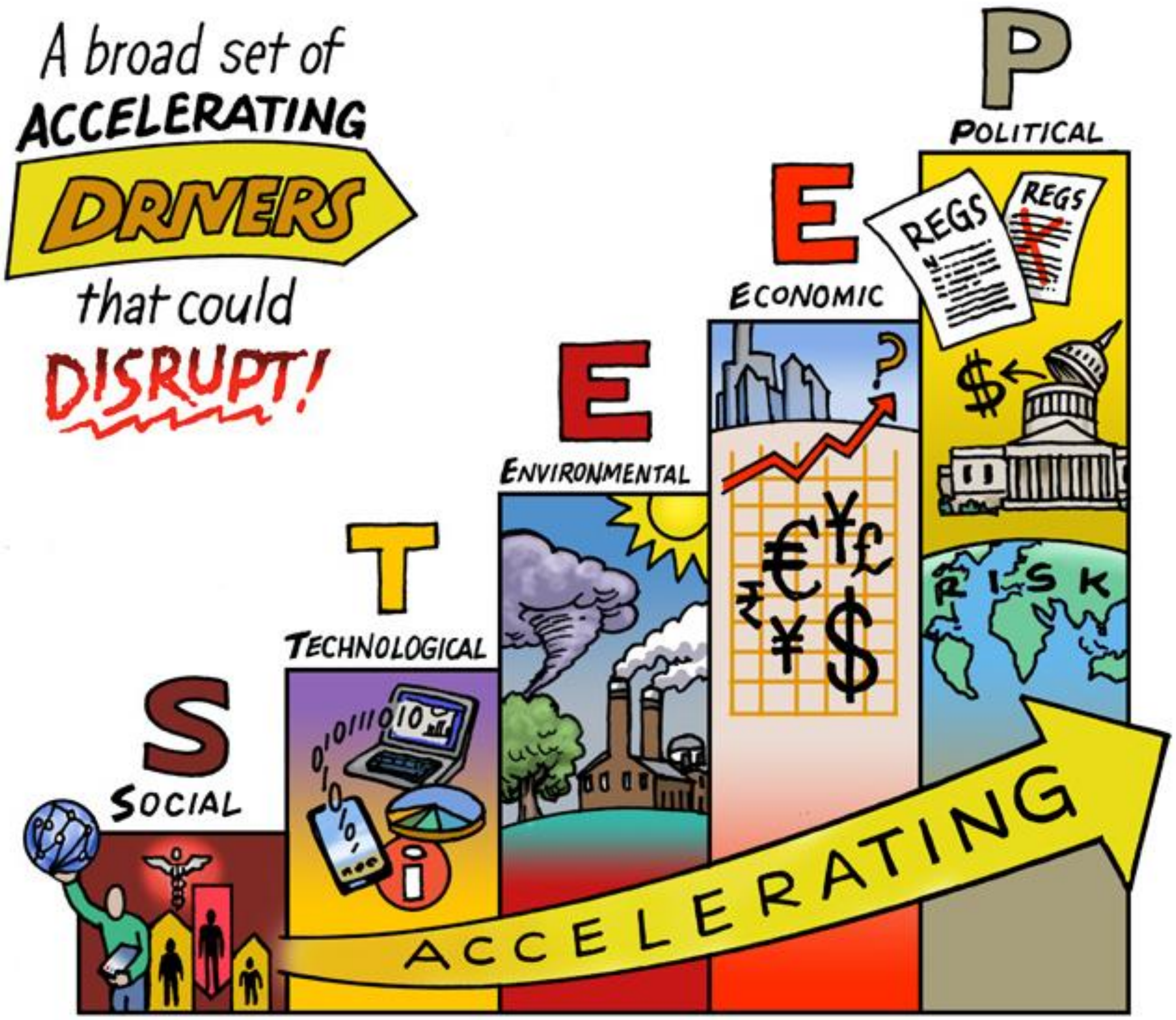
The forces driving change



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STEEP drivers in more detail….

Social

Customer Behaviours
- Social networking
- Customer expectations
- Health

Talent Drain
Stakeholder Trust
Corporate Social Responsibility

Demographic Shifts
- Dynamics of the Middle Class
- New family structure
- Dependency ratio
- Aging

Economic

Urbanisation
Risk sharing & transfer
Fiscal pressure
Social security & benefits
Inflation/deflation
Distributor shift
Partnerships
New growth opportunities

Technology

Information & analysis
Devices & sensors
Software & applications
Medical advances

Political

Regulatory reform
Geo-political risk
Rise of state directed capitalism
Terrorism
Tax treatment
Sharia compliance

Environmental

Climate change & catastrophes
Sustainability
Pollution

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Environmental

Climate change & catastrophes
Sustainability
Pollution

Key to success in the "New Normal"

The insurance market is experiencing an unprecedented period of ***disruption***

What worked in the past ***won't succeed in the future***

Insurers will need to ***adapt***

Who will succeed through this disruption?

We will focus on the following three areas…

1. Market segmentation
2. Investment strategy
3. International growth

Ned Flanders – Representing "Baby Boomers"

His background

- Likely to have well-paid job/good pension provision
- Will have children, possibly from more than one relationship
- Likely to own his home
- Reasonable level of savings, built up over working career
- Considering options now approaching retirement

His lifestyle

- Likely to use technology at work, and some use in personal life… but will prefers more traditional methods
- Will pay specialists for financial advice
- Likely to prefer to deal with people rather than computers

Most insurers already understand this

How the successful insurer will meet his needs

- Security of return from savings is paramount
- New options for releasing wealth at retirement
- Protection for dependants, as well as means of passing on wealth
- Personal trusted relationship with an adviser

Grandpa Simpson – Representing "Silent Generation"

His background

- In retirement
- Likely to have children and grand-children
- May be widowed
- Likely to own home and may have reasonable private pension
- In poorer health as a result of manual career
- Is concerned about need for long-term care and its costs

His lifestyle

- Will own a computer, and uses the internet for simple things…but doesn't trust it for important things like banking/insurance
- Likely to have a land-line, but no mobile telephone
- Only wants to deal with people

How the successful insurer will meet his needs

- Guaranteed products which provide stable income in retirement
- Long-term care product to protect wealth, as recommended by Dilnot
- Means of passing wealth to children and grand children
- Telephone/face to face relationship with adviser

Most insurers already understand this

Lisa Simpson – Representing "Generation Y"

Her background

- Has a university degree
- Little or no savings, and likely to have student debt
- Will enter property market at an older age
- High living costs, so can afford only minimal pension contributions
- May get married more than once
- Will have children later in life

Her lifestyle

- Uses technology for everything…from supermarket shopping to online banking using mobile technology
- Won't pay for financial advice – and has no trust in banks
- No desire for face-to-face/telephone sales

This is the "New Normal" – do insurers understand this?

How the successful insurer will meet her needs

- Simple products, which are easily digested
- Flexible products that cope with her changing needs
- Will require an innovative way to fund her retirement
- Online sales and administration at the leading edge of technology

Equity markets have picked up over 2013 but remain volatile, with long-term prospects uncertain

Government bond yields remain at historically low levels – possibly depressed by QE

Traditional assets are failing to generate the returns required by insurers

Traditional “buy and hold” approach to investment strategy is often leading to under performing asset portfolios

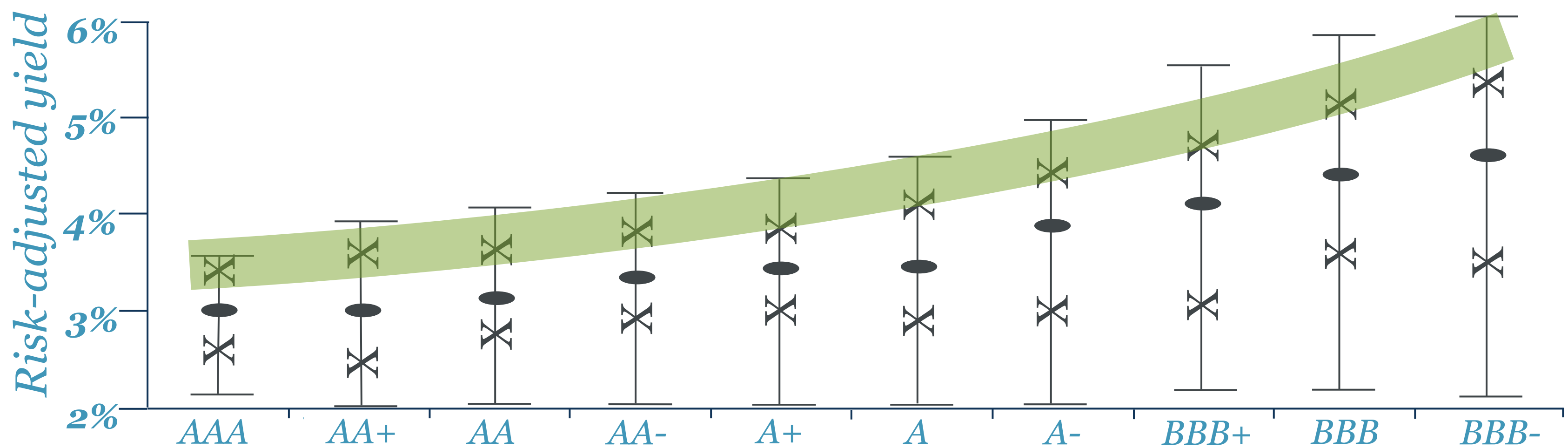
Guarantees offered on with-profits contracts are increasingly “in the money”

Some implications for insurers

- Writing competitively priced annuities
- Designing saving schemes of the future
- Making a profit from unit-linked business
- Replacing investment variance’s contribution to profit

Market segmentation | Investment strategy | International growth

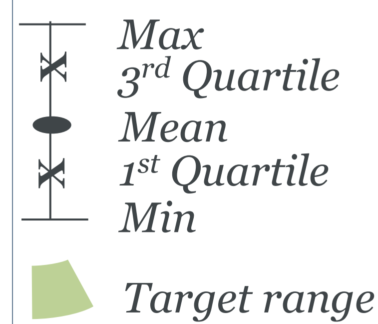
Optimising returns from your asset portfolio



Significant difference in yield earned on best and worst performing assets (of the same rating and duration)

Adopting an active investment strategy ensures insurers target investment in best performing assets

Failing to actively manage means insurers are missing out on the best returns offered within the market



Some insurers are investing in new/alternative asset classes

- **These are often illiquid**
- **Provide good “match” to annuities**
- **Offer higher return for a similar level of risk**

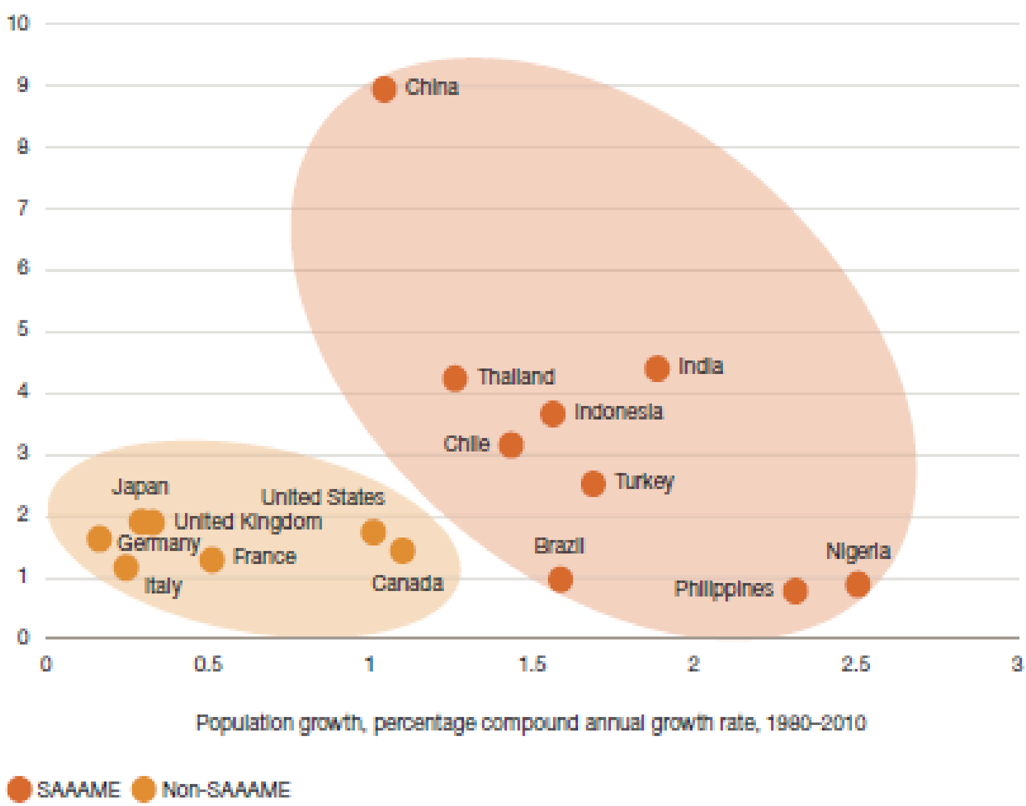
It remains unclear exactly how these non-traditional assets will be treated under Solvency II…

…but likely to require some restructuring to remove prepayment risk in order to qualify for a matching adjustment

Market segmentation | Investment strategy | International growth

Rising middle class in the emerging world

GDP per capita growth; percentage compound annual growth rate, 1980–2010



Sources: United Nations Population Division; World Bank World Development Indicators and PwC analysis
Notes: GDP per capita is in constant 2005 US$

By 2030 half the world's population will be living in Asia

Over the next 30 years 1.8 billion people are expected to move into cities – most in Asia and Africa

Urbanisation reduces family sizes, increasing demand for pensions and life insurance

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Concluding thoughts

Concluding Thoughts

- New Normal is upon us
  - Subdued growth and investment for next 3-5 years
  - Prospect of transition to a “New Growth Phase” for better adapted Western economies
  - UK interest rates should stay low; inflation relatively high
- In addition to economic and political factors,
  social technological and environmental drivers offer great opportunities (and threats) for insurers
- Is your organisation prepared?

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Questions **Comments**

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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

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