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The end of internal optimisation

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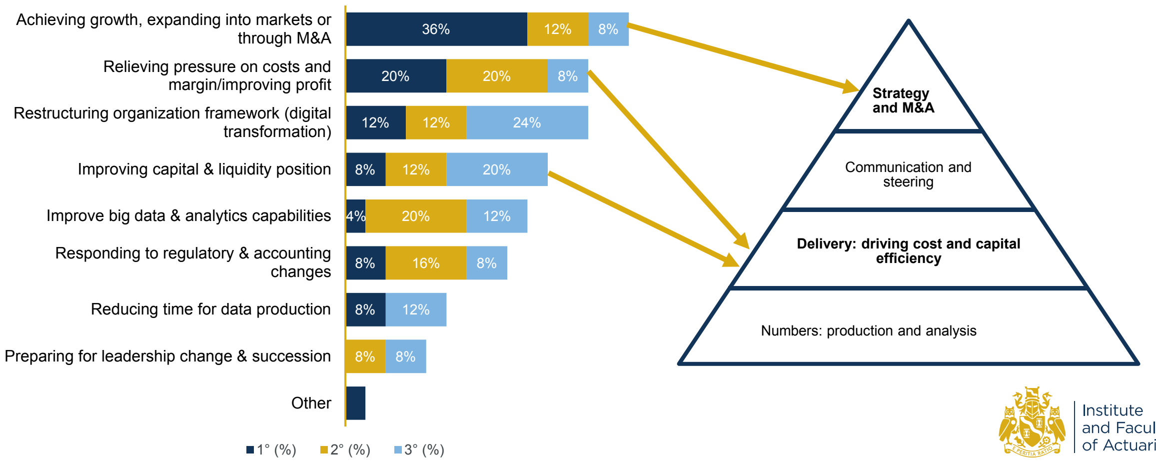
20 November 2018

Optimisation is still high on CFO's minds

EY Insurance CFO survey outputs

Maps to the overall CFO agenda



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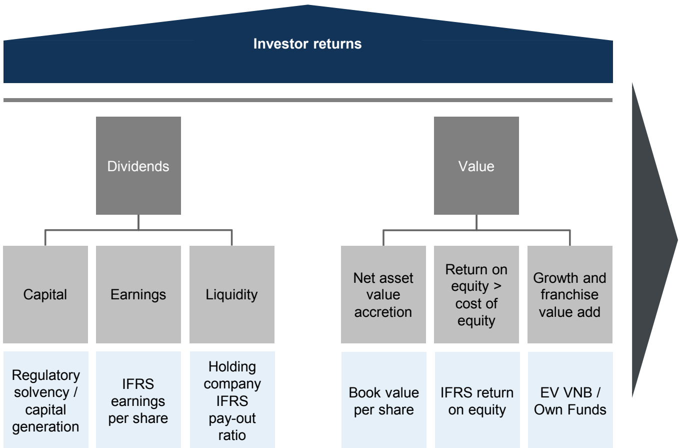
Optimisation also targets an increase in investor returns



Examples of optimisation driving value for investors

M&A, disposals and reinsurance:
- Earnings
- Capital
- NAV accretion
- RoE>Cost of Equity
- Growth and franchise value add

Solvency II LTGs and TMTP:
- Capital

Mixers/Internal Reinsurance:
- Capital
- Liquidity

Unit Matching:
- Capital
- Liquidity

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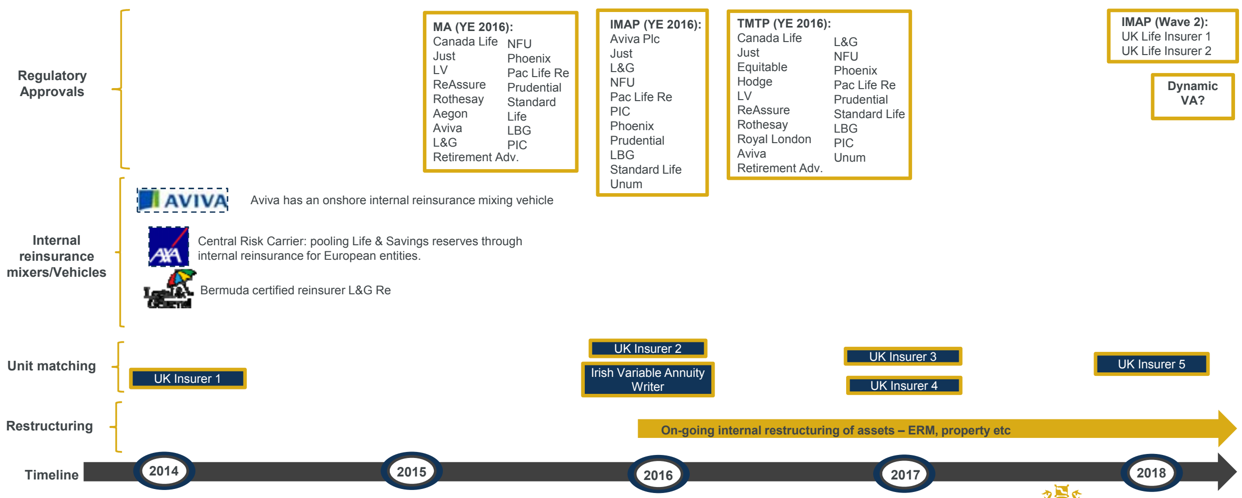
Examples of internal optimisation



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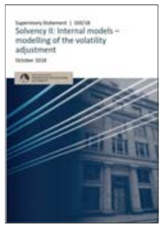
Is this really the end of internal optimisation?

- Most firms conducted large optimisation activities in the run-up to Solvency II.
- There are still areas insurers can improve (e.g. asset restructuring), but these are likely to have a smaller impact than the initial surge.
- Insurers always need to be prepared for regulatory change, which may result in optimisation – but this is likely to be reactive.

Large transformative optimisation techniques are more likely to be externally focussed in the future.

Upcoming regulatory changes (may lead to some level of optimisation):

PRA's CP on the MA allowed for liabilities backed by ERMs.



PRA's guidance of modelling DVA for IM firms.

TMTP and Liquidity guidance from the PRA likely to be published in the near future.

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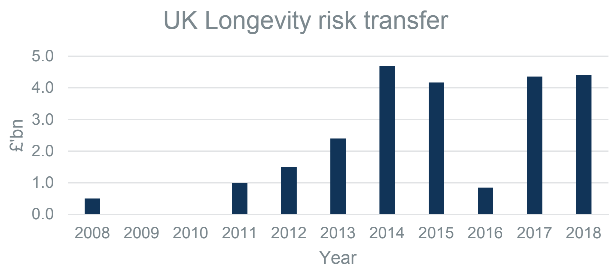
External optimisation – longevity risk transfer



Source: http://www.artemis.bm/library/longevity_swaps_risk_transfers.html
Includes longevity risk transfers from insurance companies to reinsurers.
Excludes pension buy-ins/buy-outs and pass-through deals to reinsurers.

- Longevity risk transfer from the UK is likely to continue.
- Increase in asset based deals along with longevity risk transfer in recent years
- Driven by Solvency II capital requirements for annuity business.
- Insurers' back-book is likely to be sufficiently optimised.
- Ongoing risk transfer is expected as pension buy-in and buy-out activity continues.

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External optimisation through M&A has continued

2016

- April 2016 Aegon UK sold annuity business to Rothesay Life and Legal and General
- April 2016 Just Retirement and Partnership merger
- May 2016 Phoenix Group have acquired AXA Wealth's pensions and protection businesses
- September 2016 Phoenix Group acquired Abbey Life

2017

- August 2017 Athora acquire Aegon Ireland
- August 2017 Canada Life UK acquired Retirement Advantage
- October 2017 LBG acquired Zurich Insurance's UK workplace pensions and savings business
- December 2017 Legal & General sold Mature business/WP division to ReAssure

2018

- February 2018 Phoenix Group acquired Standard Life Assurance Limited
- March 2018 Prudential UK sold annuity book to Rothesay Life
- June 2018 Equitable Life transferred business to LCCG
- June 2018 AIG Life acquired Ellipse (Munich Re)
- June 2018 Canada Life UK sold closed UK book to Scottish Friendly.

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Case Studies

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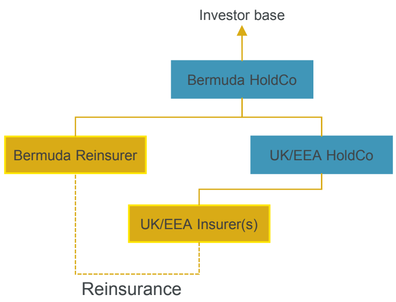
Case study 1: Reinsurance/M&A of EEA life risks to Bermuda



Benefits of Bermuda Hold Co structure

- Reduced political risk, e.g. from UK's departure from the EU.
- UK/EEA holding company allows ease of future M&A activity in the EEA.
- Bermuda reinsurer allows reinsurance to Solvency II equivalent regime which may be more capital efficient.
- Bermuda one of the largest reinsurance jurisdictions in the world with a respected regulator.
- Can include EEA reinsurer in structure, to reinsure risks from jurisdictions that penalise reinsurance to Bermuda (e.g. Belgium). This may increase diversification benefits – i.e. "mixing risks".

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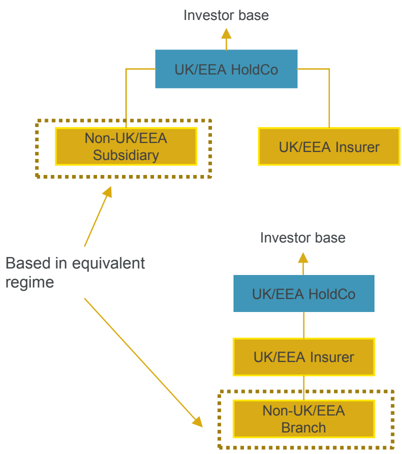
Case study 2: EEA based group acquiring non-EEA business



Considerations around acquiring business through an insurer or a branch in an equivalent regime

- Subsidiary may allow local capital requirements at Group level under Solvency II D&A rules
- Branch may allow diversification with other business in the host entity
- Cash efficiency
- Capital efficiency at entity level
- Tax efficiency
- Intra-group reinsurance
- Market competitiveness

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Conclusion

Optimisation is still high on the agenda
Internal:
- Still an area of activity, but most of the immediate work completed.
- More likely to be bespoke, strategic and reactive.

External:
- Firms continue to look strategically at their businesses.
- Increasing appetite to take big decisions, which is unlikely to reduce in the future.

New entrants are increasingly set up with capital efficient structures embedded from outset. Consolidators are reinsuring and buying European insurance risk.

How does Brexit impact the optimisation landscape?

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Questions

Comments

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