The end of internal optimisation
Mark Godson & David Burton, EY

Optimisation is still high on CFO’s minds

EY Insurance CFO survey outputs

- Achieving growth, expanding into markets or through M&A: 36%, 12%, 8%
- Relieving pressure on costs and margin/improving profit: 20%, 20%, 6%
- Restructuring organization framework (digital transformation): 12%, 12%, 24%
- Improving capital & liquidity position: 8%, 12%, 20%
- Improve big data & analytics capabilities: 8%, 20%, 12%
- Responding to regulatory & accounting changes: 8%, 16%, 8%
- Reducing time for data production: 8%, 12%
- Preparing for leadership change & succession: 8%, 12%
- Other: 8%

Maps to the overall CFO agenda

- Strategy and M&A
- Communication and steering
- Delivery: driving cost and capital efficiency
- Numbers: production and analysis
Optimisation also targets an increase in investor returns

Examples of optimisation driving value for investors

- Earnings
- Capital
- NAV accretion
- RoE > Cost of Equity
- Growth and franchise value add
- Solvency II LTGs and TMTP:
  - Capital
  - Mixers/Reinsurance
  - Capital
  - Liquidity
  - Unit Matching
  - Capital
  - Liquidity

Examples of internal optimisation

Aviva has an onshore internal reinsurance mixing vehicle

Central Risk Carrier: pooling Life & Savings reserves through internal reinsurance for European entities.

Bermuda certified reinsurer L&G Re

Management Approval:
- MA (YE 2016):
  - Canada Life
  - J Jill
  - ReAssure
  - Phoenix
  - Standard Life
  - L&G
  - Retirement AIA
- IMAP (YE 2016):
  - Aviva Plc
  - J Jill
  - L&G
  - NFU
  - Pac Life Re
  - PIC
  - Prudential
  - Standard Life
  - Unum
- IMAP (Wave 2):
  - UK Life Insurer 1
  - UK Life Insurer 2
  - UK Life Insurer 3
  - UK Life Insurer 4
  - UK Life Insurer 5

Directors: VA?

Restructuring Timeline:
- 2015
- 2016
- 2017
- 2018
- 2019

On-going internal restructuring of assets – ERM, property etc.
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 IL firms.
- TMTP and Liquidity guidance from the PRA likely to be published in the near future.

External optimisation – longevity risk transfer

- 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.

Includes longevity risk transfers from insurance companies to reinsurers. Excludes pension buy-in/buy-outs and pass-through deals to reinsurers.
External optimisation through M&A has continued

2016
- April 2016: Aegon UK sold annuity business to Rothesay Life and Legal and General
- May 2016: Phoenix Group have acquired AIA Wealth’s pensions and protection businesses
- September 2016: Phoenix Group acquired Abbey Life

2017
- August 2017: Athora acquire Aegon Ireland
- October 2017: LSG 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

Case Studies

Institute and Faculty of Actuaries
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”.

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
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?

Questions

Comments

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