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Steady as she goes:
Life insurance results 2018

Contents

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Foreword

Despite heightened political and economic uncertainty in 2018, we have seen resilience in life insurers' results. Firms have continued to implement their change programs (mainly IFRS 17), while maintaining strong capital positions and continued to deliver stable shareholder returns.

This report discusses the core themes emerging from the 2018 annual results announcements across the UK and Continental European life insurance markets, with a particular focus on the voluntary disclosures of Solvency II and supplementary Embedded Value ("EV") and Modified Solvency II Own Funds results. In this year's publication we have for the first time incorporated insurance analysts' views on an anonymised basis to provide a different perspective on the level and quality of voluntary Solvency II disclosures. As well as taking a look back at the 2018 results, we also consider the opportunities and challenges on the horizon for the insurance sector in 2019 and beyond.

In 2018, firms focussed on balance sheet strengthening and improving profitability amidst continuing Brexit uncertainty and regulatory scrutiny. For example, Phoenix, AXA, Prudential and Generali issued Tier 2 and Restricted Tier 1 debt, taking advantage of the low yield environment. Despite the one year deferral, firms have continued their momentum with IFRS 17 implementation programs, which consumed a significant amount of resources and time for most firms.

Market competition has intensified in the pension de-risking market. In the UK not only have the level and size of bulk annuity deals increased over 2018, we also saw Phoenix entering the bulk purchase annuity market signalling a shift in its strategic appetite for bulks. This has also led to continuing strong demand for illiquid assets as more firms look to take advantage of the yield uptick they offer. In addition, the European Life Insurance market continues to consolidate with an acceleration of deals in Continental Europe (in particular in Germany) largely backed by private equity firms. The ongoing low interest rate environment and growing liability burden from onerous policy guarantees are pushing some insurers to wind down all or part of their non-core businesses and reposition their strategies.

Roger Simler
Partner, Actuarial Insurance
+44 20 7303 3292
rsimler@deloitte.co.uk

Despite Brexit uncertainty, Solvency II Balance sheets have remained resilient in 2018 and have weathered the storm from market turbulence towards the end of 2018. Solvency II operational capital generation has remained stable and firms with large annuity exposures have continued to benefit from a slowdown in the rate of improvement in life expectancy through release of some of the prudence in their longevity reserves.

2018 also saw insurance supervisors across the UK and Europe taking a more active approach to certain risks. In the UK, the Prudential Regulatory Authority (PRA) has provided new guidance on the valuation of the no negative equity guarantees on Equity Release Mortgages ("ERMs") and the threat from climate risk to insurers.

Looking forward, 2019 will continue to present opportunities and challenges to life firms in a number of ways:

- As firms progress with their IFRS 17 preparations, the focus will be on selecting and implementing sub-ledgers and contractual service margin engines, while maintaining flexibility to adjust methodologies as required.
- Further disruption from InsureTech will continue to drive change.
- Climate change is rising up the Board and investors' agendas, with the newly released PRA Supervisory Statement requiring this to be reflected in governance, risk management, scenario analysis and disclosures.

I hope you find this report both insightful and thought provoking. Please do not hesitate to contact me or one of the team listed at the end of the report if you have any questions.

2018 Year in review

The majority of the firms in our sample continued to offer a progressive dividend,[1] signalling their resilience despite continued Brexit uncertainty and regulatory scrutiny. Demographic shifts led to large reserve releases from the inforce books and new business was dominated by significant growth in bulk purchase annuities.

Healthy dividend growth for firms in our sample

Brexit has remained a source of uncertainty throughout 2018, and many questions on its impacts remain unanswered. Firms have been proactive in mitigating the impacts of Brexit on their business operations and most firms have now done what they need to do to maintain passporting rights post the UK's exit from the EU.

The fact that 17 out of 20 firms in our sample (see Chart 1) declared a progressive dividend demonstrates to investors that insurers have managed to navigate the macroeconomic challenges relatively unscathed. A majority of firms who declared a dividend based it on IFRS (or equivalent) operating earnings (targeting 45%-60% of the profitability measure).

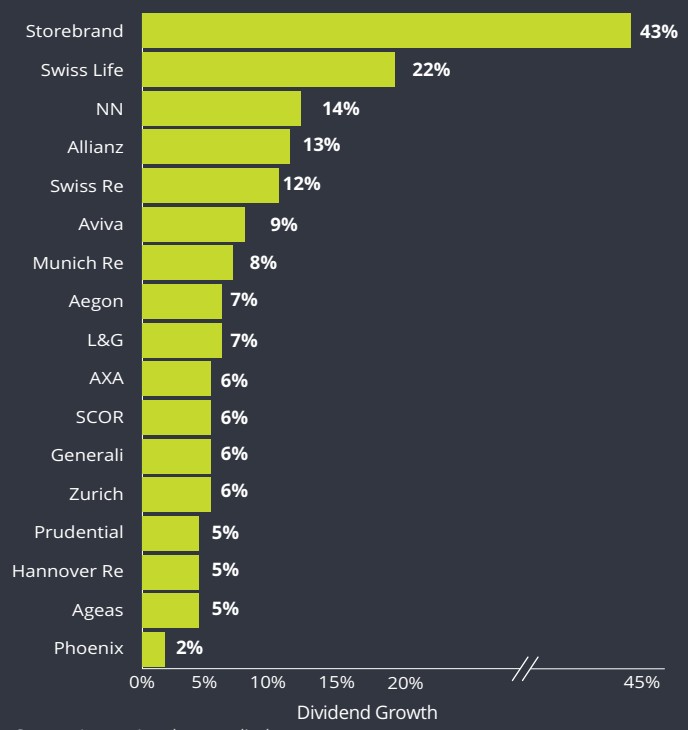
Some of the firms in our sample indicated that they would declare a dividend if the solvency coverage ratio rises above 150% and consider a progressive dividend if the solvency coverage ratio exceeds 180% - this level of increased disclosure from firms signals greater maturity of Solvency II risk appetite levels.

Further longevity releases in pipeline?

2018 saw firms updating their mortality basis (in some cases both the base table and improvement model) to reflect the slowdown in mortality improvements. In our sample, out of the seven firms who disclosed their mortality basis (see Table 1), four firms moved from CMI 2016 to CMI 2017, and the rest moved from CMI 2015 to CMI 2016, with the exception of PIC, which remained unchanged. These updates led to aggregate reserve releases in excess of c.£2.0bn.

In line with prior years, a number of firms have exercised caution in keeping pace with CMI mortality improvement models, citing the need to assess the reasonableness of the proposed CMI assumptions on their own portfolios in order to gain comfort that the slowdown reflects a genuine trend. This caution is justified, at least in the short term, as Q1 2019 data shows a reduction in the numbers of deaths, following a mild winter.

Chart 1. 2018 dividend growth



Source: Insurer's voluntary disclosures

Note: Storebrand's dividend growth excludes the special dividend declared in 2017.The growth including the special dividend is 20%

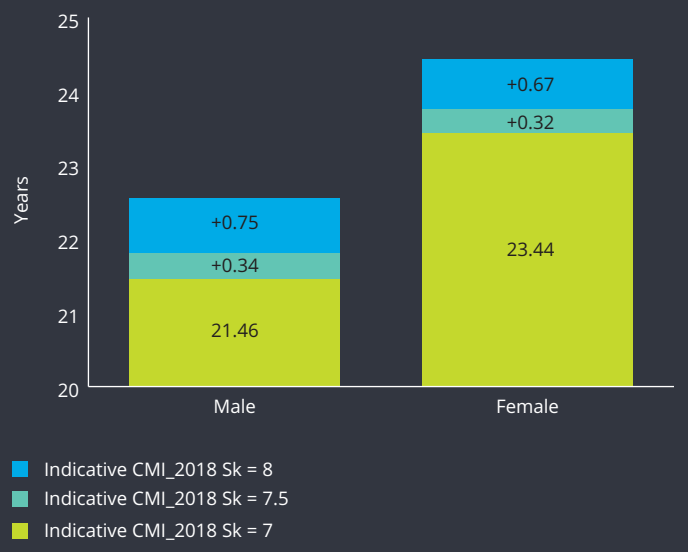
Table 1: Future improvement models used by firms in our sample

	2017	2018
Aviva	CMI 2016	CMI 2017
L&G	CMI 2015	CMI 2016
Prudential	CMI 2015	CMI 2016
Phoenix	CMI 2016	CMI 2017
Just Group	CMI 2016	CMI 2017
PIC	CMI 2016	CMI 2016
Rothesay	CMI 2016	CMI 2017

Source: Deloitte Analysis

1 A progressive dividend is defined as a dividend that is greater than the one declared in the prior year.

Chart 2. Impact of smoothing parameter on life expectancy at age 65



Source: Deloitte Analysis

In late 2018, the CMI announced the results of its 2018 analysis (and released the CMI 2018 model in March 2019), which proposed lowering the smoothing parameter from a core value of 7.5 to 7. This shift places more weight on recent higher mortality rates, potentially leading to a significant reduction in life expectancy (see Chart 2). At the same time, a new extended parameter has been added to the CMI 2018, to allow for an "initial addition to mortality improvements" to allow users to adjust the initial mortality improvements more easily. This may counteract some of the impact from the lowering of the smoothing parameter.

With CMI 2018 supporting the continuing trend in slowdown in improvements in life expectancy, and Q1 2019 data showing a significant reduction in deaths, firms are more likely to exercise caution when considering further longevity releases at year-end 2019.

Continued growth in the pensions de-risking market.....

2018 was another record year for the bulk annuity market. Established players in the bulk annuity market were not the only firms with an increased appetite, with Phoenix entering the bulk annuity market in 2018 (an addition to its long-standing closed book strategy). The profit margins for the bulk annuity providers in our sample remained stable (6.5% to 8% compared to 5% to 9% in 2017), signalling that pricing has remained competitive despite increasing demand from schemes as funding levels improve.

The newly founded consolidators, Clara and The Pension SuperFund are looking to disrupt the pension de-risking market by offering employers an alternative, and arguably a cheaper solution to insurance risk transfer. This comes against a backdrop of the development of a new regulatory framework for the commercial consolidation market. We expect the demand for the new consolidators to be driven by corporate activity such as M&A in the first instance, where there is a driver for paying cash in return for a clean break from defined benefit liabilities.

... and increasing appetite for illiquid assets

With increasing appetite for bulk annuity deals, investments into illiquid assets continue to rank highly in annuity writers' strategic priorities. The PRA recently indicated that illiquid asset allocations are expected to increase from current levels of around 25% to 40% by 2020. In 2018, annuity writers (e.g. L&G, Rothesay) increased their asset allocation to illiquid assets, particularly to infrastructure assets (e.g. green energy, future cities and hospitals) and commercial real estate loans. While firms are seeking increased yield and diversification, they are also using this as a mechanism to drive socially responsible asset allocation. We expect this trend to continue as firms look to pursue investment strategies that support ESG ("Environmental, Social and Governance") investments. With increasing levels of illiquid assets, also comes increased focus from the PRA on the associated risks, including scrutiny on governance and quality of internal rating mechanisms. It also supports increased levels of bulk annuity deals and in turn further longevity hedging across the sector.

Accelerating consolidation in the life insurance sector

2018 saw the European Life Insurance market continue to consolidate with an acceleration of deals in Continental Europe largely backed by private equity firms. The continuing low interest rate environment and growing liability burden from onerous policy guarantees are pushing insurers to wind down all or part of their non-core businesses and reposition their strategies. This is particularly evident in Germany where Generali's sale of its German life unit to Viridium is a game changer. The transaction has a new and innovative structure which provides a potential solution to the challenges of high guarantee traditional business. FITCH forecast that run-off specialists will manage more than half of closed life business in Germany by 2022, compared with about 25% currently, as insurers start to find the costs of managing shrinking portfolios an increasing burden. Elsewhere in Europe the strategy of disposing of non-core assets continues and Cinven's acquisition of AXA Life Europe is a good examples of this.

We also saw a continuation of the recent trend of life insurers venturing into wealth management in order to move from the high capital, high costs, low multiples world of insurance to one with lower capital and higher multiples. Recent examples include Prudential's merger of its fund management business M&G, with its UK and European life insurance arm and Aberdeen Standard Life selling the Standard Life business to Phoenix. Phoenix and ReAssure continue to actively compete on closed book deals and at the time of writing ReAssure is moving towards an IPO in late 2019.

Following L&G's sale of the mature savings (including the with-profit fund) book to ReAssure at the start of 2018, we saw Equitable Life striking an innovative deal with Utmost Life and Pensions (previously known as LCCG), where Equitable is using a Scheme of Arrangement to unitise most of its with-profits business and as a result distribute capital which is currently tied up covering guarantees. We expect this to be the start of a wave of with-profit consolidation in the UK as smaller with-profit funds consider consolidation as a route to improve member returns through capital and cost synergies.

Looking ahead, consolidation is set to expand in Continental Europe. Anbang's withdrawal from the market has led to a very competitive processes around Vivat in the Netherlands and Fidea in Belgium. We expect to see other markets starting to open up with deals in Spain and Portugal. Given the success of consolidation now that Solvency II has bedded in, we anticipate that other more challenging markets such as France will open up in 2019.

IFRS 17 continues dominate firms' change programmes in 2018

Most firms spent 2018 defining and testing their initial IFRS 17 methodologies, with a focus around the impact of transitioning to IFRS 17. One of the key decisions firms have to make is the choice between Modified Retrospective Approach (MRA) or a Fair Value approach upon transition to IFRS 17. The choice will affect the transition Balance Sheet and the pattern of emergence of future profits.

Our experience suggests that for older blocks of business, much of the Contractual Service Margin will have amortised by the date of transition, and a fair value approach for these tranches of legacy business may suffice. Where there is insufficient historical data available companies will have a choice of approaches, and the optimal answer may depend on methodologies yet to be finalised. As a result, it is crucial that companies build flexibility into their development programmes which allow them to respond to emerging results.

Regulatory scrutiny on certain risks

Regulatory developments over the last year have included valuation of ERMs, London Inter-bank Offered Rate (LIBOR) discontinuation and climate risk. With plenty of airtime on the first of these, we focus our attention on the latter two:

01. The Financial Conduct Authority sent a Dear CEO letter in September 2018 after making it clear that LIBOR discontinuation was not a "black swan event". In light of this firms have begun to address the many operational issues the change requires, including renegotiating their LIBOR referencing assets such as hedges, illiquids, longevity swaps and SPVs.

    We envisage the lack of liquidity in assets referencing alternative benchmarks and short-term volatility in SONIA swaps as firms renegotiate positions being the main sources of risk for insurers.

02. In April 2019 the PRA issued a supervisory statement in relation to financial risks arising from climate change, which requires allocation of climate risk management responsibility to the Senior Management Function, and for firms to consider long-term climate-related stress and scenario tests within their ORSAs.

    We expect an increase in climate-related disclosures in 2019, and more generally an increasing need to integrate climate risk considerations into risk management practices and wider business strategies.

Solvency II Results – continued capital resilience

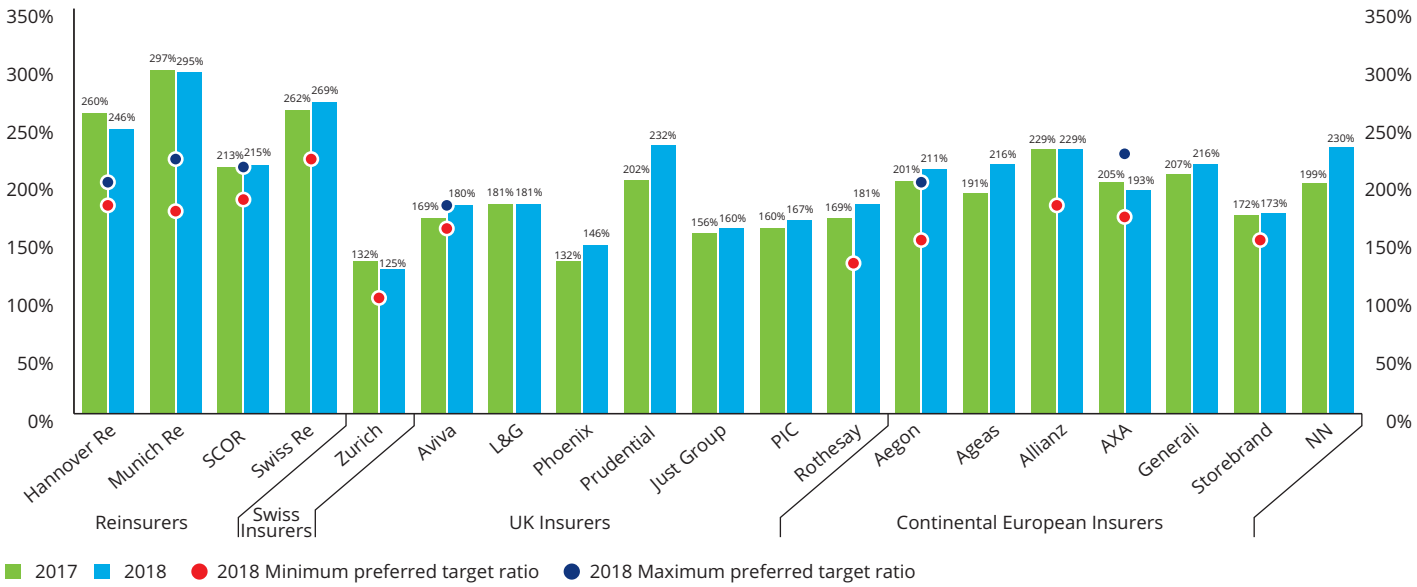
Most firms' capital positions remained resilient over 2018, with a number of them taking action to optimise their Solvency II capital compositions. The level of voluntary Solvency II disclosures varied across the firms in our sample, with insurance analysts keen to see improved disclosures of market and combined sensitivities, analysis of movement for Solvency II metrics and bridges between IFRS and Solvency II balance sheets.

Solvency II coverage ratios continue to be strong across firms

Firms in our sample reported a Solvency II coverage ratio in excess of 150% with reinsurers disclosing ratios well in excess of 200% (see Chart 3). The high level of capitalisation for reinsurers is driven by the necessity to demonstrate strong solvency positions to achieve a strong credit rating to facilitate risk transfer under Solvency II. As expected, firms that are open to new business typically have slightly lower capital coverage ratios, as capital is consumed in writing new business.

The average increase in Solvency II coverage ratios between 2017 and 2018 is 6%pp compared to a 9%pp uplift observed between 2016 and 2017. For those firms disclosing a slightly weaker solvency position in 2018 relative to 2017, the reasons given included dividend pay-outs and M&A activity leading to an increase in capital requirements. There was limited movement in the solvency targets across firms, signalling that firms are comfortable with their risk appetite levels.

Chart 3. YE 2018 Solvency II coverage ratios



Source: Voluntary disclosures

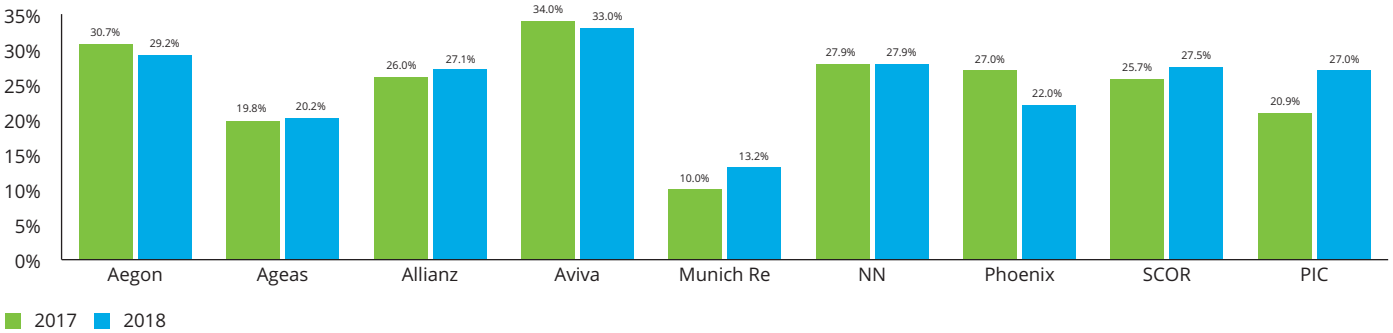
Notes:

- Swiss Re's Solvency II coverage ratio is based on the Swiss Solvency Test ratio (SST).
- Zurich's Solvency coverage ratios is based on Zurich Economic Capital Model ratio (Z-ECM).
- L&G's 2018 Solvency II coverage ratio includes the impact of recalculating the Transitional Measures for Technical Provisions (TMTP) as at 31 December 2018. The coverage ratio on a shareholder view is 188%.
- Phoenix's Solvency II coverage ratio is estimated and includes the impact of a regulator approved recalculation of transitional for Standard Life Assurance Limited only.
- Prudential's Solvency II coverage ratio is based on the shareholder view, which excludes the contribution of the ring-fenced With-Profits and staff schemes in surplus.
- Just Group 2018 Solvency II coverage ratio is pro-forma allowing for a £300m Restricted Tier 1 debt and £80m equity issuance proposed in early 2019, and 2017 is pro-forma allowing £230m subordinated debt issue in February 2018.
- Rothesay moved to modelling its credit and counterparty risk capital using a Partial Internal Model in 2018, having previously used Standard Formula in 2017. This change was the main factor behind the increase in Solvency II coverage ratio.
- AXA's Solvency II coverage ratio disclosed based on AXA's internal model and assuming equivalence for AXA Equitable Holdings, Inc.

More deleveraging to follow?

With most firms well capitalised, we expect more firms to deleverage in 2019. This supports the general sentiment from a few firms (including Aviva and Aegon) who disclosed that they expect to deleverage in the future. In 2018, 9 firms in our sample published a debt leverage ratio.

Chart 4. 2018 debt leverage ratios

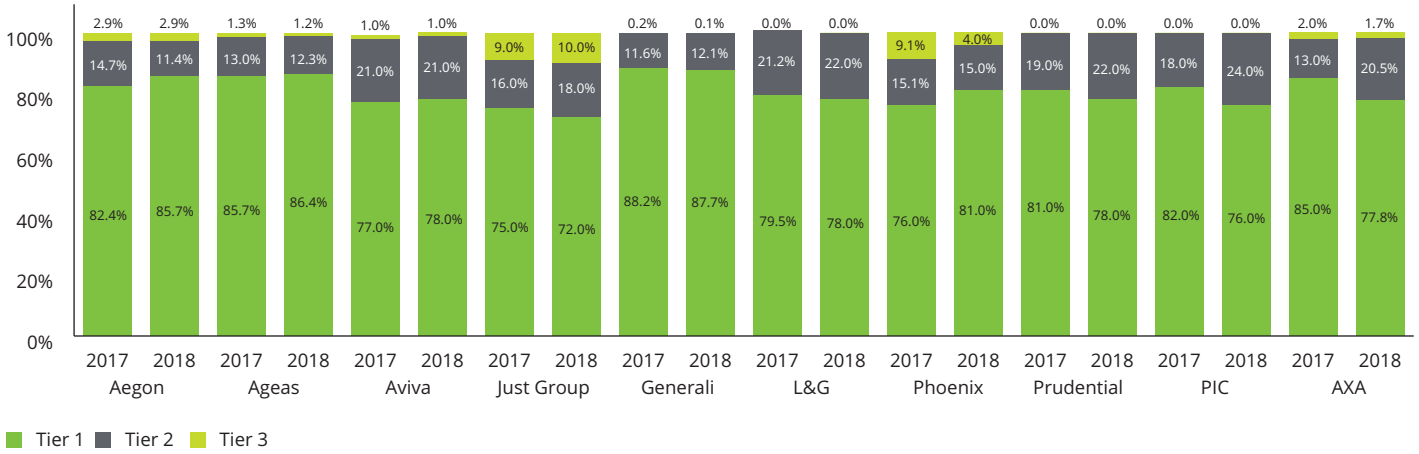


Source: Voluntary disclosures
Notes: Firms have varying definitions of debt leverage ratios, so ratios presented may not be directly comparable

Movement between Tier 1 and Tier 2

Across the sample, the proportion of Tier 1 debt has on average decreased and Tier 2 debt has increased (see Chart 5).

Chart 5. Analysis of capital tiering



Source: Voluntary disclosures

With Tier 1 debt grandfathering due to come to an end in 2026, there are initial signs that firms are taking the opportunity to rollover their grandfathered debt and issue new debt to avoid having to force sell in the future. For example, in 2018, Phoenix, AXA, Prudential and Generali issued Tier 2 debt rather than replacing Tier 1 on a like-for-like basis.

The proportion of Tier 1 debt has increased at Aegon, Ageas and Phoenix in 2018. Aegon issued Restricted Tier 1 ("RT1") debt during 2018 as it had no capacity to issue Tier 2 capital, and Phoenix issued RT1 debt as part of the Standard Life deal. RT1 is a relatively new Solvency II compliant debt instrument and is similar to subordinated debt but carries greater risk to the investor as there is loss absorption triggered by low Solvency Capital Requirement ("SCR") and Minimum Capital Requirement ("MCR") coverage ratios.

With the exception of Just Group, Tier 3 capital has reduced across the sample. This may signal a reducing appetite for Tier 3, with credit rating agencies generally giving no credit for Tier 3 capital in their capital assessments.

Solvency II analysis of change disclosures provide opportunity for greater transparency and consistency

Those firms (12 out of the 20) who disclosed an analysis of change in Solvency II position in 2017 did so again in 2018. These analyses cover either one of Solvency II surplus, coverage ratio, own funds, SCR, or a combination of these. As per last year, Solvency II surplus is the most prevalent disclosure, with 7 out of 12 firms disclosing on this basis.

We continue to see a lack of consistency in the steps presented in the analysis of change and the approach taken to group different items in the analysis making outside-in analysis challenging.

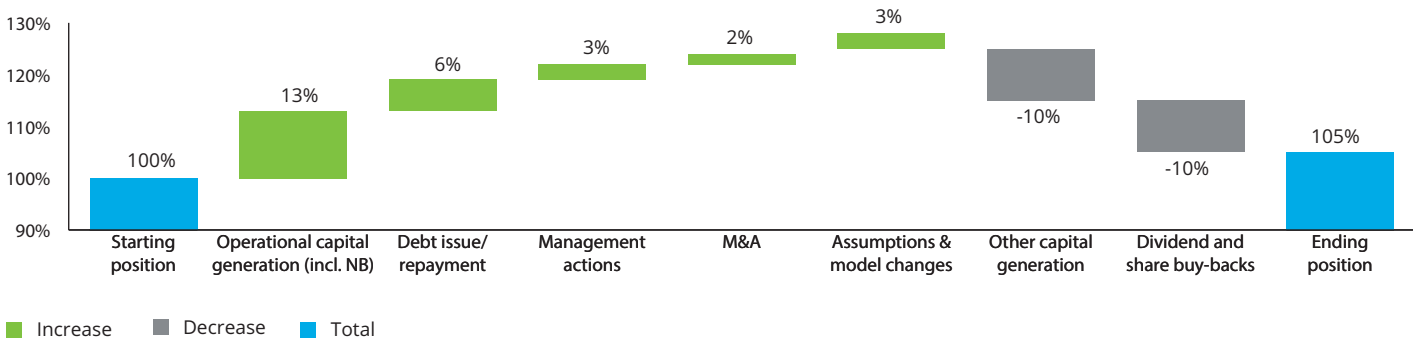
"...scope for more transparency and harmonisation of disclosures of analysis of change in Solvency II surplus, scenario testing results & bridge from IFRS net equity to SII Own Funds."

Source: David Rule, PRA

"....we would like firms to enhance semi-annual voluntary Solvency II disclosures by including some key operating metrics."

Source: Insurance Analyst

Chart 6. Analysis of change in Solvency II surplus



Source: Voluntary disclosures, Deloitte analysis
Note: Due to rounding the ending position may not add up to the sum of the starting position and component movements

Strong operational generation driving Solvency II surplus

In Chart 6 above, we have shown the development of the overall analysis of change of Solvency II surplus for those companies in our sample publishing on this basis. There has been a 5% increase over the period.

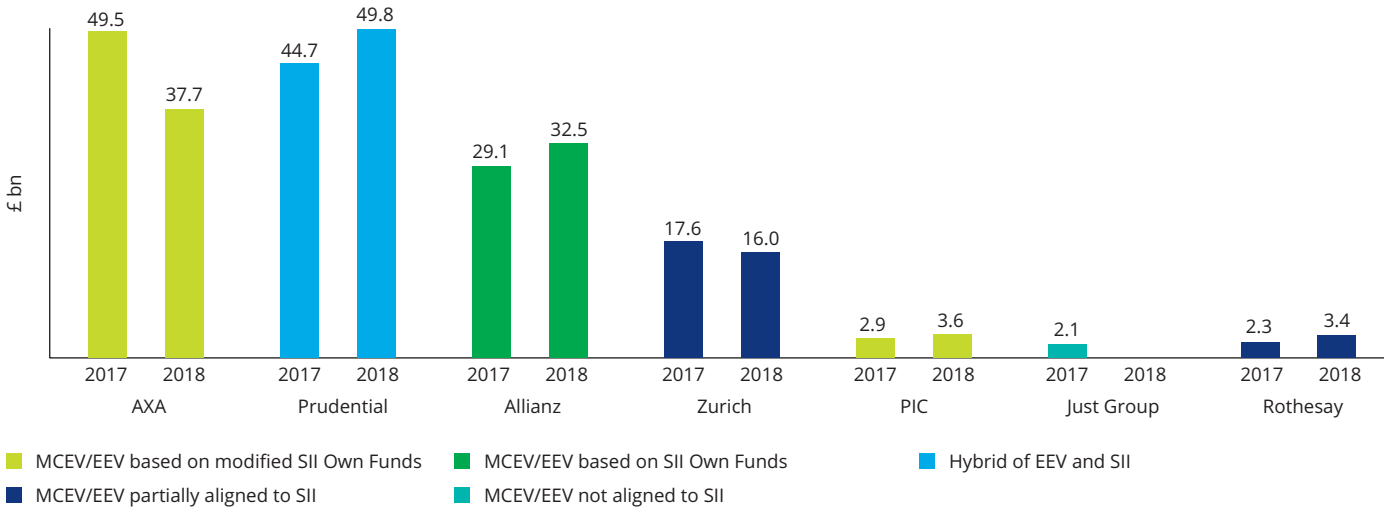
The primary drivers of the increase in Solvency II surplus over 2018 are strong operational capital generation (including the release of Risk Margin and SCR and expense under/over-runs) and raising new subordinated debt capital. This was partly offset by 'other capital generation', which includes the impact from adverse market movements, dividends and share buybacks.

Dividends range from c.20% to c.80% of operating capital generation, which suggests that all firms in our sample paid a dividend using operational capital generation. Share buybacks continue to feature heavily, with 7 out of the 20 firms offering share buybacks, and two further firms announcing their intention to do so in 2019. This level of share buyback activity is not surprising given the level of capitalisation we have observed at year-end 2018.

Economic Value Reporting

The few remaining firms that publish EV have either fully or partially aligned to Solvency II results. Only two firms in our sample adopted a modified Solvency II Own Fund approach, suggesting that firms are not yet ready to replace EV with an alternative supplementary measure.

Chart 7. Reported EV by approach

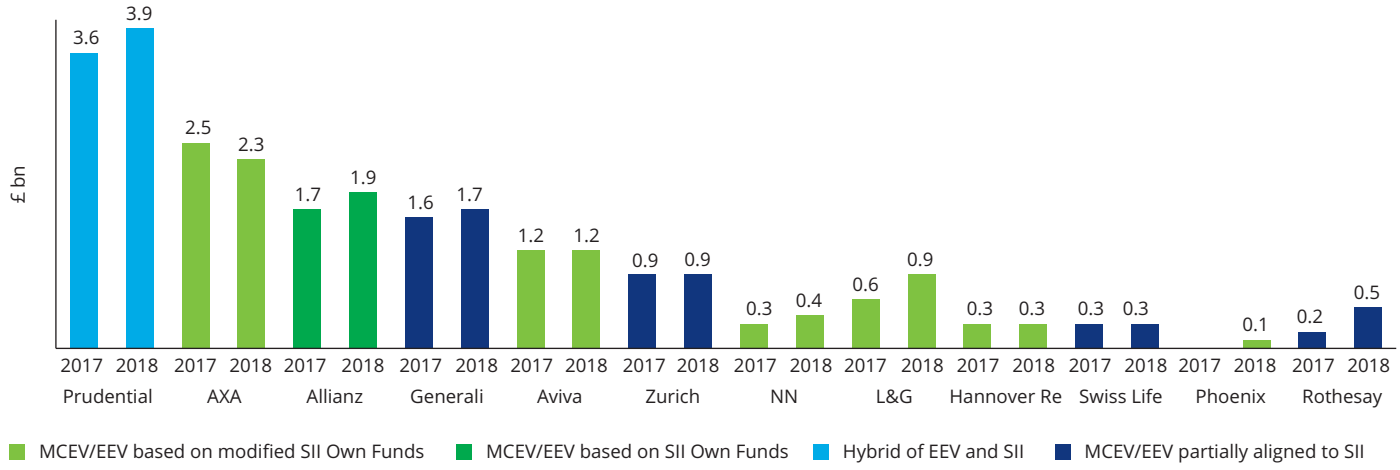


Source: Voluntary disclosures

In line with last year, we have seen a continued decline in the number of firms reporting EV figures, with Just Group ceasing the publication of a value metric in 2018. As expected, no companies have adopted the publication of a value metric, where they did not already do so. Companies that continue to report EV and/or Value of New Business ("VNB") metrics have maintained their 2017 methodologies for producing these measures.

Across our sample of firms who reported an EV (see Chart 7), we observed a general growth in EV primarily driven by strong new business sales, particularly in respect of Prudential and Allianz and to a lesser extent Pension Insurance Corporation. Despite AXA recognising a large VNB, this did not translate into an increase in EV due to the Initial Public Offering ("IPO") and subsequent sell-down of AXA Equitable Holdings ("AEH"). In contrast, Rothesay Life experienced an increase in EV driven by a capital injection relating to the acquisition of an annuity portfolio from Prudential.

Chart 8. Reported VNB by approach



Source: Voluntary disclosures

Although EV reporting is declining, many firms disclose a Solvency II Own Funds based VNB. This recognises that Solvency II metrics do not necessarily provide a view on new business written during the year separately.

The majority of firms in our sample reported a modest increase in VNB (see Chart 8) over the year with only AXA recording a reduction, due to the IPO of AEH, adverse currency movements and higher sales volumes of low margin products. The largest growth in VNB was observed from Prudential, L&G and Allianz. Prudential's growth was driven by strong sales in Asia. L&G delivered an increase in VNB, through higher sale volumes than last year, despite experiencing a decrease in margin caused by increased competition in the UK Retail Protection market. Allianz highlighted an increase in sales volumes and a continued move to capital efficient products as the key factors behind their VNB growth.

"....the move to providing Modified Own Funds metrics is taking longer than hoped for."

Source: Insurance Analyst

Limited Modified Own Funds ("MOF") Disclosures

Although MOF remains a useful internal value measure, and especially in M&A transactions, we are yet to see many firms adopting it as a supplementary measure in their voluntary disclosures. Only two firms in our sample adopted a MOF disclosure – PIC and AXA, who also did so in 2017. This may be because firms feel that Solvency II already provides a reasonable proxy to value with relatively straightforward adjustments (that are easily accessible). Also with IFRS 17 on the horizon, firms may be reluctant to provide an additional set of supplementary disclosures, with the operational complexity that entails.

Is adjusted IFRS 17 an alternative economic value measure?

As IFRS 17 will be a financial reporting basis that will be subject to an external audit, it provides a path to derive an economic value for a life insurer. In this year's report we provide some initial thoughts to provoke further discussion on this topic.

Starting with a quick re-cap, the insurance liabilities under IFRS 17 will comprise of three main components:

Present value of future cashflows on a best estimate basis	Similar to Solvency II Best Estimate Liabilities with differences around contract boundaries, expenses and discount rates.
A risk adjustment to reflect uncertainty in cashflows	Similar to Solvency II Risk Margin but with more flexibility around the cost of capital and the confidence interval level.
The contractual service margin ("CSM")	This measures the present value of future profits on the contract at inception and then subsequently the amount of deferred profits for the contracts still held on the balance sheet as it runs off. At inception it is similar to VNB.

A key disclosure that is of interest to an investor under IFRS 17 is the development of the CSM over the year, which will be derived from the analysis of change in liabilities. In the general IFRS 17 approach, the main steps in the rollforward of the CSM will be as follows:

The amortisation of the CSM releases profits from the contract into the income statement. This is driven by the service provided in the year compared to future years which is typically measured using the sum assured in-force.

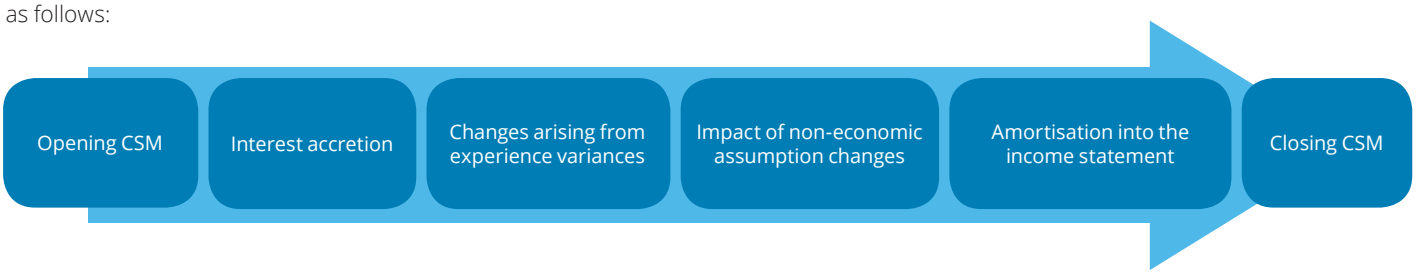
Deriving an economic value:

Although the CSM is analogous to the present value of future profits at inception under EV, it does not capture the amount and timing of future profit emergence in the same manner as EV, due to the mechanism to release profit described above. Given this, one approach is to use an adjusted net asset value ("ANAV") to derive an economic value measure by considering the following adjustments:

- Remove the CSM from the insurance liabilities to recognise profits currently being deferred.
- Adjust for the effect of contract boundaries and the allocation of expenses.
- Restate the risk adjustment to be market consistent.

In addition to adjustments to the IFRS 17 insurance liabilities, adjustments to any other assets and liabilities in the business being valued would need to be considered in a similar manner to how they are currently treated.

Firms are currently in the process of setting up and working through implementation programmes in advance of the effective date of the standard in 2022 and consequently we expect the thinking on this topic to develop further.



"....IFRS 17 should assist with performance analysis as it provides a globally consistent valuation standard and a greater consistency between IFRS and Solvency II."

Source: Insurance Analyst

Opportunities and challenges ahead

We have drawn out a number of opportunities and challenges that we expect companies to address throughout 2019 and beyond.

IFRS 17

Companies are at various stages with their IFRS 17 implementation programmes. Many have already selected, or are in the final stages of, vendor selection for a sub-ledger and/or Contractual Service Margin calculation engine. Implementation of either of these is complicated by the need to understand a new technical accounting standard, continued evolution of some of the solutions and the need to get to grips with what is often a completely new software platform. As observed in the period before the implementation of Solvency II, this is not always optimal as methodologies evolve while companies develop their understanding of requirements, which can lead to a cycle of redesign and rebuild. We have seen, and recommend that companies leverage full working prototype solutions to set the blueprint for their business requirements and functional specifications to avoid a cycle of inefficient developments and bolt on spreadsheet solutions.

Illiquid assets

With annuity writers looking to expand their illiquid asset portfolios particularly focusing on Infrastructure assets, developing the capabilities to source these assets in a timely manner becomes critical as annuity writers compete for the same assets. Some firms have navigated this through co-sourcing while others have leveraged their in-house asset management capabilities. Unlike ERMs, which have been around for some time now, there is limited data and market precedence for infrastructure assets. This poses a challenge in particular when determining the appropriate levels of capital requirements under Solvency II. This challenge is further exacerbated by increased scrutiny from the regulator on the treatment of illiquid assets as we saw in 2018, with the PRA in the UK setting out a number of policy statements on the valuation and capital treatment of ERMs.

InsureTech

As the General Insurance and Health Insurance markets become saturated with start-ups, Venture Capital ("VC") firms and the VC arms of insurers are increasingly looking at the whitespace around the Life Insurance market. The rapid innovation that has been felt across the GI value chain is starting to penetrate the conservative Life and Pensions sector, which lags behind the banking sector in respect of the breadth and quality of their digital offerings. This movement is the result of an increasing number of banking focused FinTechs seeking to gain access to the £3tn Pensions asset pool, through broadening their offerings. As consumers more and more come to expect frictionless 'always on' digital platforms to be the new normal mode of engagement, new parties are developing solutions which could result in full scale disruption. Should Life firms fail to react quickly to this threat, they increase the risk of falling behind the agile insure-tech players, who launch innovative products at competitive prices. One potential advantage the firms have over these new entrants is their access to enormously rich policyholder data, if only this can be accessed (and then analysed) from their legacy systems.

Climate Change

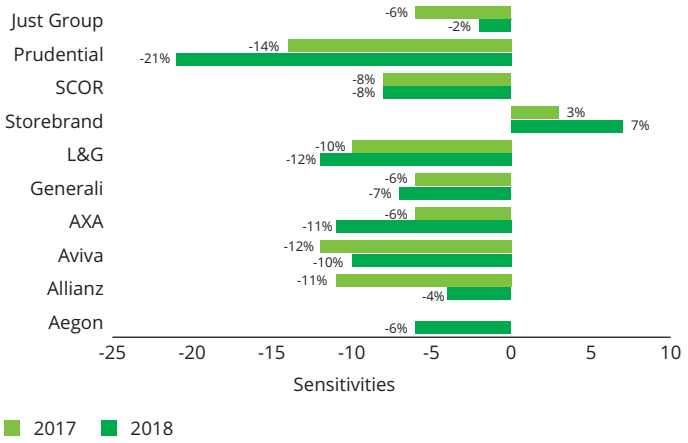
The effects of climate change on all industries, including the Life and GI markets, are coming into sharper focus. Changing weather patterns can affect demographic assumptions (Life) and claim expectations (GI). Asset valuations are impacted by government policy (e.g. carbon taxes) and disruptive technology (e.g. falling cost of renewable energy - the European energy sector has written off $150bn of stranded assets since 2008). We have already seen some firms start to quantitatively analyse the risks and opportunities and adapt their strategy. We expect this trend to accelerate, as investors and regulators across the world see climate risk as a material threat to firms' business models. The recently released PRA Supervisory Statement requiring this risk to be reflected in governance, risk management, scenario analysis and disclosures, is just one example of the drivers of change in companies behavior in what is no longer considered an emerging risk, but rather an emerged risk.

Appendix A – Sensitivities

In last year's report, we highlighted the increasing harmony in the disclosure of sensitivities by the insurers we analysed. We have seen this trend continue in this year's results reports, particularly when looking at the economic sensitivities reported. The exception to this observation is the reporting of sensitivity to interest rate up stress. All firms in our sample disclosed a 50bps up, and a 50bps down stress (see Chart 9) except for Prudential, L&G, Aviva and Just Group who disclosed a 100bps up stress.

Firms' are negatively impacted by a 50bps down stress, except Storebrand. This may be explained by their exposure to guaranteed products.

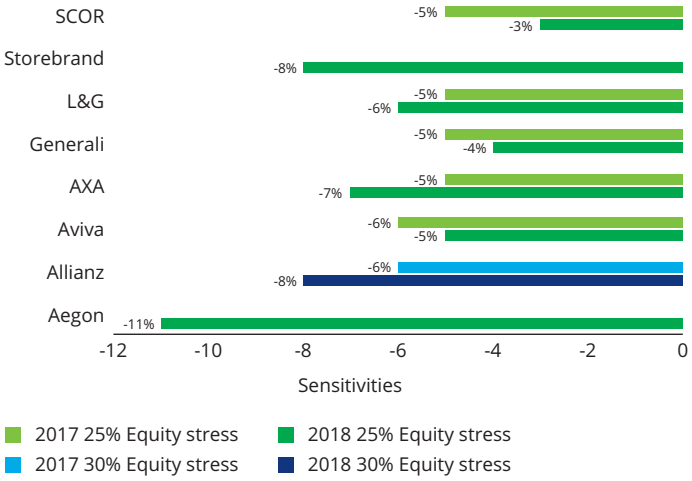
Chart 9. Sensitivity to decrease in interest rates: 2018 vs 2017



Source: Voluntary disclosures

There is no clear trend in changes in sensitivities versus last year. As mentioned above, this may reflect the difficulty that comes with sourcing long duration assets. Our observation last year of Prudential being most at risk to interest rate down stresses remains true this year, with Prudential's sensitivity to interest rate down stress having increased to 21% from 14% last year.

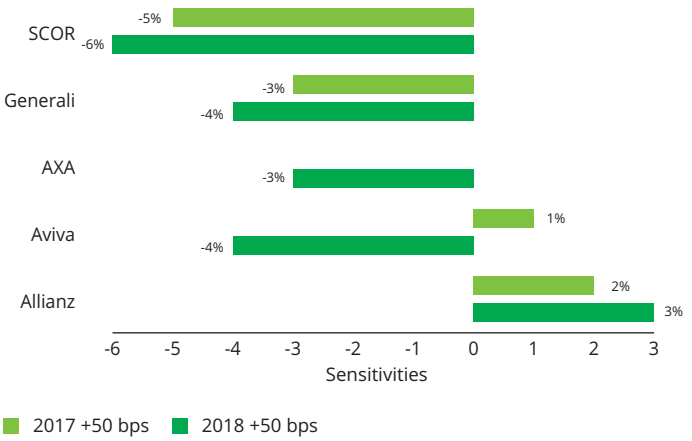
Chart 10. Equity down stress 2018 vs 2017



Source: Voluntary disclosures

When looking at equity sensitivities versus 2017 sensitivities, no clear trends emerge - some firms are more sensitive to equity down in 2018 versus 2017 and others are less sensitive to equity down in 2018 versus 2017. Aegon can now be compared to the other firms having changed their equity stress reporting to 25% down.

Chart 11. Credit spread up: 2018 vs 2017



Source: Voluntary disclosures

There is an observable trend that firms' solvency coverage ratios are generally more sensitive to widening credit spreads in 2018 than they were in 2017, as can be seen in the Chart 11. This may reflect underlying changes in investment strategy with increased holdings in high yield credit versus 2017.

Appendix B – List of firms in our sample

Firm		
Aegon	Just Group	Rothesay
Ageas	Legal & General ("L&G")	SCOR
Allianz	Munich Re	Storebrand
Aviva	NN Group	Swiss Life
AXA	Phoenix	Swiss Re
Generali	Pension Insurance Corporation ("PIC")	Zurich
Hannover Re	Prudential	

Appendix C – Contact details

UK

Roger Simler
+44 (0) 20 7303 3292
rsimler@deloitte.co.uk

Richard Baddon
+44 (0) 20 7303 5570
rbaddon@deloitte.co.uk

Kanchana Kahakachchi – Author
+44 (0) 20 7303 0503
kkahakachchi@deloitte.co.uk

Australia

Caroline Bennet
+61 (03) 9671 6572
cbennet@deloitte.com.au

Austria

Daniel Thompson
+49 221 973 2444
danthompson@deloitte.de

Belgium

Dirk Vlaminckx
+ 32 2 800 2146
dvlaminckx@deloitte.com

Canada

Paul Downes
+1 416 775 8874
pdownes@deloitte.ca

Central Europe

Jiri Fialka
+420 246 042 622
jfialka@deloitteCE.com

Cyprus

Marios Schizas
+357 22 360 326
mschizas@deloitte.com

France

Claude Chassain
+33 1 40 88 2456
cchassain@deloitte.fr

Germany

Nils Dennstedt
+49 403 2080 4463
ndennstedt@deloitte.de

Hong Kong

Simon Shau Ming Dai
+852 2238 7348
simondai@deloitte.com.hk

Ireland

Ciara Regan
+353 1407 4856
cregan@deloitte.ie

Italy

Alessandro Ghilarducci
+39 0283 323057
aghilarducci@deloitte.it

Netherlands

Marco Vet
+31 882 881 049
MVet@deloitte.nl

Scandinavia

Thomas Ringsted
+45 27 142 044
tringsted@deloitte.dk

South Africa

Peter Tripe
+27 214 275 364
ptripe@deloitte.co.za

Spain

Jose Gabriel Puche
+34 9144 32027
jpuche@deloitte.ch

Switzerland

Simon Walpole
+41 582 797 149
swalpole@deloitte.ch

US

Jason Morton
+1 612 397 4048
jamorton@deloitte.com

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