European Life Insurance Back Book Management 2017

Results of our 2017 survey of
life insurance back book management and
run-off across Europe

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Contents

Introduction

Welcome to our Survey of Life Insurance Back Book Management in Europe. This survey complements the highly successful survey 2018 Global Insurance Run-off Survey (www.pwc.com/globalinsurancerunoffsurvey) focussing on the non life insurance market which has been running now for over 10 years.

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Whilst this is the first survey of life insurance back book management to be published by PwC, management of discontinued life insurance is not new. This report looks at some of the tools and techniques available to manage back books, whether they be a firm which is closed to writing new policies or represent policies written years ago which are no longer core to active insurers. The report also includes summaries of the level of M&A activity in those European markets where activity is likely to be greatest.

Increased focus across Europe on back book management

The results of our survey indicate that management of the back books of life insurance firms is expected to become an increasingly active strategy. Restructuring solutions, including exit transactions, are already happening in the market, with new entrants from non traditional backgrounds entering to provide additional solutions or capacity. Our survey suggests that over 50% of respondents are anticipating some form of restructuring activity in the next 18 months – we believe this figure is understated.

Across continental Europe insurers are being forced to take a more economic view of the capital requirements under the new Solvency II regime, with a range of solutions being taken to optimise capital positions. This is likely to lead to further closures of lines of business, leading to more transactions to divest discontinued products and businesses, and to exit markets completely.

Further M&A activity anticipated as European markets consolidate with new entrants to the consolidation market

There are already increasing levels of M&A activity amongst some of the larger insurers, and developing consolidation in the larger European markets of Germany, Italy and the Netherlands. The UK has consolidated significantly, but with further opportunities anticipated, in particular as the implications of Brexit become clearer. New entrants to the markets include private equity firms, following the likes of Cinven and Apollo, and Chinese investors such as Fosun and Anbang continue the wave of consolidation across Western Europe, with longer term pension fund money also starting to invest. Experience gained from the many years of consolidation in the UK can provide valuable lessons, and the lack of outsourcing capabilities in Europe no longer appears to be proving the barrier it once was.

The survey includes responses from industry, advisor and private equity participants across Europe. We are extremely grateful to everyone who has taken part in this survey and has provided their insights. We encourage you to contact us to discuss the outcomes of the survey and the market and we look forward to continuing to support you in the future.

Executive summary and key findings

Executive summary and key findings

The results of our survey indicate that management of the back book of life insurance business is expected to become an increasingly active strategy being pursued by firms.

The c.€6.7bn[1] European life insurance industry is the most developed across the world. Many of the largest global insurers call Europe their home, and large legacy portfolios of savings and protection business exist in almost all markets across Europe. The chart to the right demonstrates the size of the European market.

Solvency II has introduced new challenges to the industry, demanding companies to provide greater levels of public disclosure with an increased burden of cost, which has led to some products such as annuities and guaranteed return products being far less attractive to insurers due to the high levels of associated capital. Incentives such as tax breaks and investment guarantees historically offered on life insurance products are slowly being removed which increases competition from other industries such as asset managers and banks. The sales process in some countries has also come under increased scrutiny in part due to historic past practices, and the nature of the bancassurance model favoured across much of Southern Europe is facing structural and capital challenges.

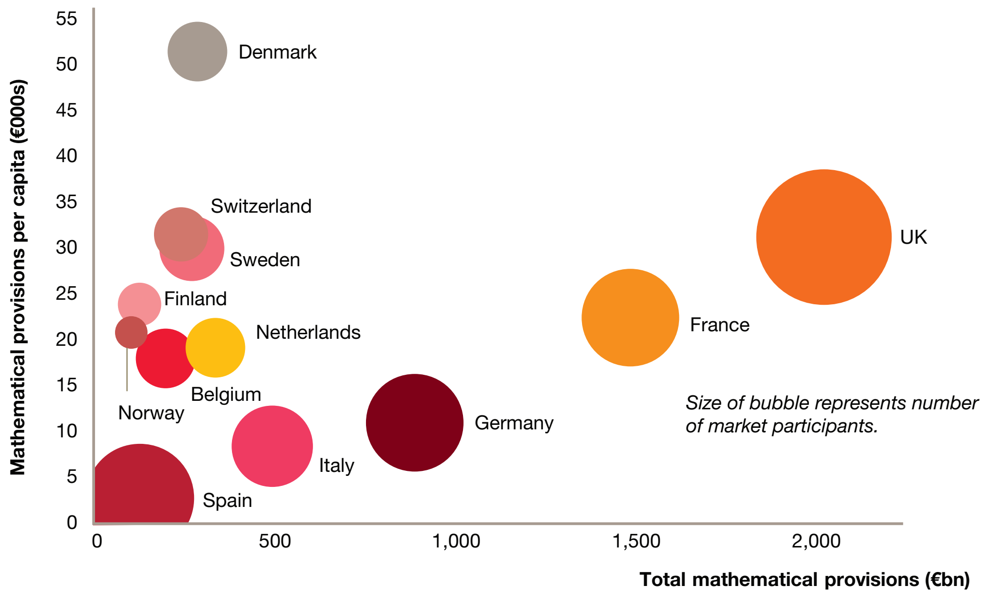
The change in the regulatory regime and the challenges of operating in a low interest rate environment has not prevented new investors and we are witnessing a new wave of consolidation across much of Europe as investors seek longer term stable returns and insurers seek efficiencies and exit solutions.

The past 18 months have therefore been an exciting time for M&A activity across the life insurance sector. Our survey off closed book life insurance businesses, seeks to understand the drivers of recent activity in the market and to understand what will lead to future activity. The results of the survey support our views that further activity and consolidation is on its way, with the UK, Germany and France expected to be the key markets for activity in the near term.

Consolidation within the UK life insurance industry is not new. Historically, consolidators such as Phoenix, Resolution and ReAssure have changed the landscape of the UK industry. A new wave of consolidation across the UK is expected in the coming years, with much of the focus likely to be on UK annuity and with-profits products.

Consolidation across the remainder of Europe is in a relative infancy, but has begun. In recent years, private equity and Chinese investors have been acquiring non core operations from some of the larger European insurers, with their strategy focussed around seeking alternative asset strategies and optimising capital, whilst achieving valuation and expense synergies and driving a hard bargain on price.

Mathematical provisions per capita compared with total size of each market and the number of insurers[1]



[1] Figures from CEA Europe.

Source: CEA Europe, NB UK figures as at 31/12/2014, Other markets as at 31/12/2015.

The results of our survey demonstrate that the UK market (which continues to be the largest market by size) will see further consolidation. The UK industry continues to have more insurers than any other in Europe, however, consolidation in France, Germany and Italy could be expected as these continue to be sizeable markets where little consolidation activity has happened to date.

*What are the **key objectives** of your legacy/back book run-off plan? (Responses ranked high to low)*

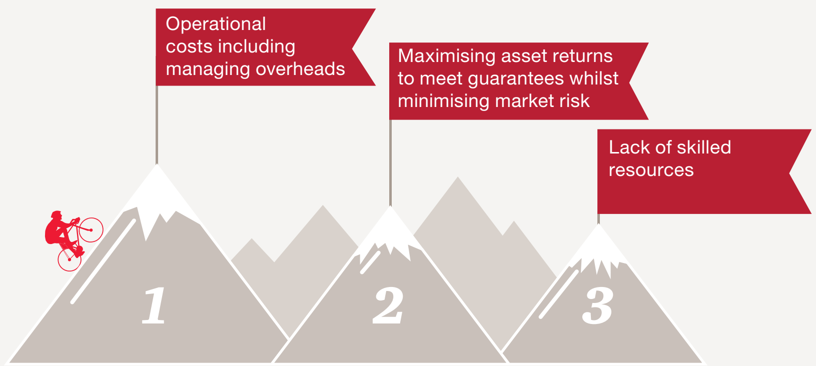
The results of our survey show that the current low interest rate environment remains the top issue for many firms as they seek to find alternative investment strategies and new assets to achieve a higher return to meet legacy guarantees.

With such a challenging investment outlook, shareholder returns and value might be improved through maximising economies of scale and minimising the expenses of the business.

The results of the survey show that minimising expenses remains high on the agenda for many firms, and is a significant driver of consolidation activity and management of cost cutting and efficiency programs. The principal challenges faced by insurers are nothing new, however, the changing regulatory environment has increased the cost burden on insurers across Europe as the industry has spent vast amounts of money in readiness for Solvency II and subsequently in ensuring appropriate disclosures.

Optimising asset strategy, in terms of investment returns and regulatory capital, is absolutely crucial for firms to achieve their strategic objectives. We think the ability to source and structure alternatives to traditional credit investments is a key differentiator.

*What are the **top three challenges** facing your businesses in managing legacy run-of business?*



*What would **increase the likelihood** of a legacy solution for your business?*

*What **businesses** are likely to be restructured?*

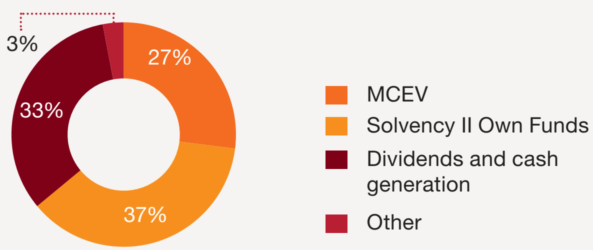
Capital intensive products such as deferred annuity and savings with guarantees continue to be the core businesses that the market are looking to restructure.

Deferred annuity business scored highly amongst survey participants as the most concerning area of business in Europe. The combination of high guaranteed annuity rates, longevity improvements, together with the low interest rate environment and a lack of very long dated assets make these products the most complex to manage.

Unit linked business
Savings with guarantees business
Deferred annuity business
Participating savings business
Inforce annuity business
Protection business

*What **pricing** metric will you use?*

Following the implementation of Solvency II, Own Funds is becoming the most important pricing metric in deals. We would expect an acquirer to use Solvency II Own Funds as a starting point for the valuation of a life insurer, however, a number of significant adjustments are likely to be required to reflect the true economic value of the business, and whether capital can actually be paid to shareholders or remains trapped within the business to support the inforce book.

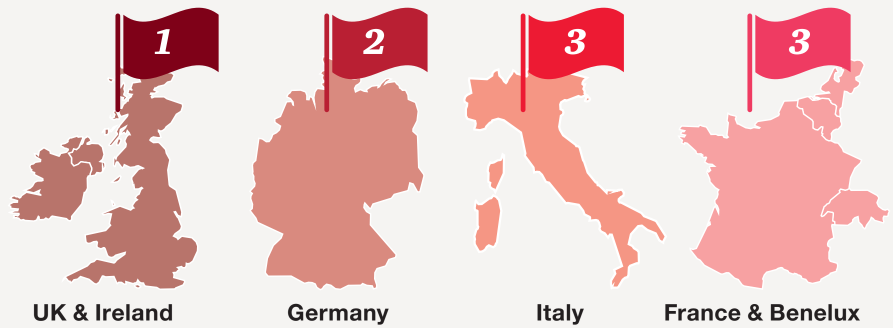


*Which **countries** do you anticipate most activity happening?*

The results of our survey suggest that the UK insurance industry will continue to be the forerunner of M&A activity as evidenced during 2017, with the major European markets, specifically Germany, Italy and France expecting to see activity.

M&A in the life run-off space will increase because of a combination of factors:

- awareness of the opportunity;
- significant ‘dry powder’ within global funds (which are also generally under-penetrated in insurance);
- the opportunity for higher returns in an environment of long term low global interest and competitive premium margins; and
- the ‘forced driver’ of Solvency II.



What is the likelihood of your business restructuring or exiting over the next 18 months?

50%

Highly likely or likely

*What are the tools for **restructuring?***

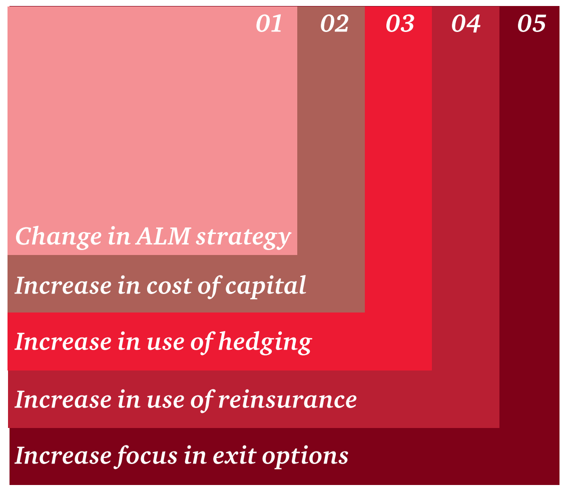
Most respondents have chosen sale or transfer as their preferred solution.

With Solvency II in place for two years, insurers are now starting to get to grips with what this means for capital and returns, recognising that there is an opportunity to optimise through more efficient use of capital with a wide range of tools available.

*What have been the **practical implications of Solvency II?***

The practical implications of Solvency II are wide-spread. However, there is an increased focus on risk management activity. Drivers of this include the increased capital requirements under Solvency II, as well as the inclusion of the risk margin in the liabilities.

Insurers have spent large amounts of time and resources over recent years on implementing Solvency II and have had to overcome many of the practical difficulties of implementation. The next 18 months promises to be a time of change as insurers move away from the implementation phase into optimising capital and enhancing shareholder returns.



The results of our survey indicate that management of the back books of life insurance business is expected to become an increasingly active strategy being pursued by firms.

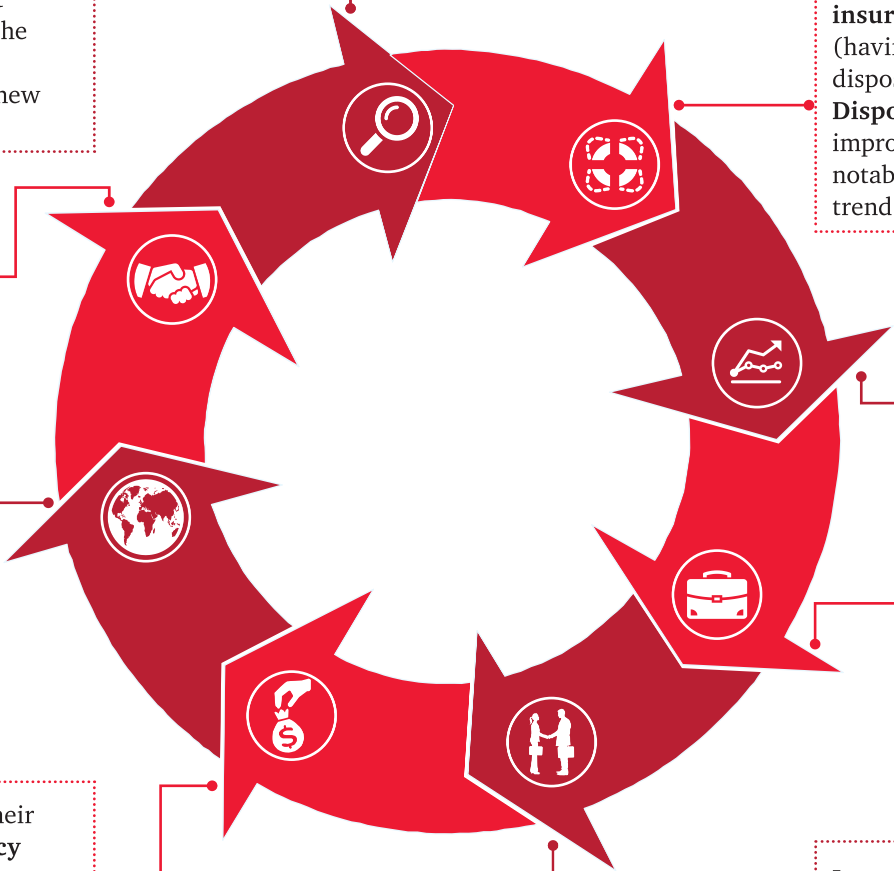
The findings of our report suggest that European consolidation activity is driven by a number of factors, including:

Increased focus on the **cost base of insurers** who are running on old platforms that are no longer fit for purpose, and the subsequent challenges over the management of the expenses of the business and diseconomies of scale in a firm no longer writing new business.

Continued interest from **private equity** firms, with particular interest from Apollo, Blackstone, Cinven and CVC and other longer term private capital.

Continuing interest from **large Asian conglomerates** such as Anbang Insurance Group, Dai Ichi Life and Fosun International looking to increase their international footprint, with other investors on the horizon.

Insurers are taking the opportunity to optimise their investment portfolio to **increase capital efficiency** and shareholder returns. This is being achieved by many across the industry by looking at alternative asset strategies such as infrastructure investments that offer a higher return than government bonds.



Traditional insurers looking at **disposal of non core insurance businesses** across Europe, such as Generali (having exited the Netherlands) and Aviva (successfully disposing of non core assets across Italy and Spain), **Disposal of UK annuity books** by companies seeking to improve the capital efficiency of their balance sheet with notable disposals by Aegon, Equitable Life and Zurich, a trend which we expect to continue.

Historic high guarantees on European products – with a market shift to selling new business on products with fewer guarantees and lower capital requirements.

Consolidation of the insurance mutual sector where businesses can be sub-scale, have limited access to external capital and need to explore alternative methods to compete.

Increased reinsurance activity as insurers seek to redeploy capital across their businesses using more sophisticated tools.

Life insurance M&A since the inception of Solvency II

Highlights in M&A activity since 1 January 2016

HY1 2016

- US private equity firm, Apollo, acquires Portuguese insurer Acoreana Seguros from Banif for €130m.
- Covéa Group investment in Scor Re for €322m.
- Phoenix Group acquires AXA Wealth's pension and protection business, including Sun Life for £375m.
- Legend Holdings Investment of £110m into Pensions Insurance corporation.
- Rothesay Life acquisition of c.£6bn and Legal and General acquisition of £3bn annuity portfolios from Aegon UK.
- Map Fre/Bank Inter acquisition of Barclays insurance operations. (price undisclosed)
- LCCG acquisition of AXA Isle of Man. (price undisclosed)

HY2 2016

- Cinven acquisition of Italian insurance companies Ergo Providenza and Old Mutual Wealth Italy through its Italian holding company, Phlavia Investimenti. (price undisclosed)
- Phoenix Group acquires Deutsche Bank's Abbey Life for £935m.
- Foreningen NLP acquisition of a 25% stake in Danish Nordea Liv & Pension for c.DKK2bn.
- NN Group acquisition of 79.9% stake in Delta Lloyd for c.€2.5bn.
- Chesnara acquisition of L&G Netherlands business for €160m.
- Barclays sale of Spanish insurance operations to Caixa Group.
- Uniqa sale of Italian operations Uniqa life S.p.A and Uniqa Previdenza in Italy to Societe Reale for €295m.

HY1 2017

- LCCG agreement to acquire Reliance Mutual. (price undisclosed)
- Cinven owned Viridium Group acquisition of German insurer Protektor Lebensversicherung. (price undisclosed)
- CVC investment in UK annuity specialist Pensions Insurance Corporation. (price undisclosed)
- Societe Generale acquisition of 50% of its French life insurance joint venture business Antaruis from Aviva for €500m.
- Fosun owned Frankfurter Leben acquisition of ARAG Lebensversicherungs-AG. (price undisclosed)
- Cinven acquisition of an 80% stake in Italian insurer Eurovita from JC Flowers through Phlavia Investimenti. (price undisclosed)
- Exin Financial Services proposed acquisition of a 75% stake in National Bank of Greece's Ethiniki Insurance for €718m.
- Santalucia Seguros acquisition of Aviva's Spanish life and pensions joint ventures Unicorp Vida and Caja España Vida and sale of retail life business Aviva Vida y Pensiones for a total of €475m.

HY2 2017

- RL360 Group acquires Friends Provident International Limited for £340m.
- Aviva sale of 50% shareholding in Avipop Assicurazioni and Avipop Vita to Banco BPM. (price undisclosed)
- Blackstone Group and GIC buyout of Goldman Sachs stake in Rothesay Life.
- Canada Life acquisition of Retirement Advantage from TDR. (price undisclosed)
- Lloyds Banking Group acquisition of £15bn corporate pensions business from Zurich.
- Norli Pension Livsforsikring A/S acquisition of portfolio of life insurance business from Skandia Link Livsforsikring A/S
- Generali sale of Dutch insurance operations to ASR. (price undisclosed)
- Storebrand Livsforsikring AS acquisition of Silver Pensjonsforsikring AS for NOK 520m.
- Aviva acquisition of Friends First Life Assurance Company for €130m from Achmea B.V.
- Legal and General sale of £33bn With Profits portfolio to ReAssure Re for £650m.

Source: PwC Analysis of public disclosures.

Detailed findings

Challenges facing a changing life insurance industry across Europe

Managing certainty over policyholder outcomes remains the key objective of businesses when managing a legacy platform. The current low interest rate environment makes achieving this a challenge.

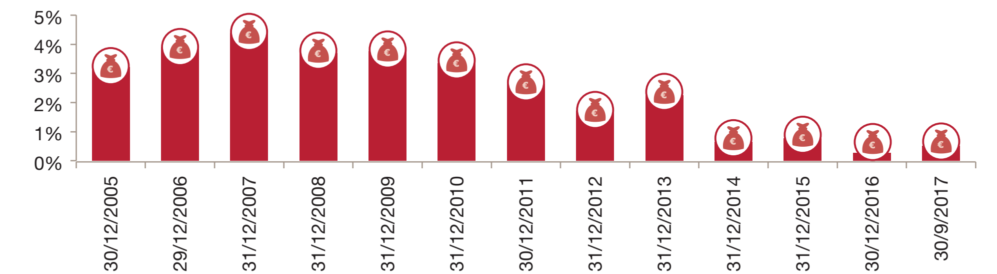
Policyholder returns and value

The results of our survey show that the current low interest rate environment remains the top issue for many firms as they seek to find alternative investment strategies and new assets to achieve a higher return to meet legacy guarantees.

Interest rates continue to be at their lowest levels across Europe for years, and have been the biggest source of pain for most European insurers. This has caused businesses to reassess their ongoing strategy. Big strategic decisions such as closing to new business, remaining open but refocusing on less capital intensive products or exiting a particular market have had to be made. Other actions such as selling legacy portfolios with high guarantees, where insurers require a high investment return to meet the promises made to policyholders, changing investment strategy or to investigate other solutions such as attempting to convert legacy products into less capital intensive products, are also options being considered across Europe.

With some of the guarantees offered by UK and European insurers being in excess of 4% on significant portions of their portfolios, many firms are opting for safer, fixed interest investment strategies in order to protect themselves and shareholders from the volatility that a more aggressive equity based strategy could involve. Whilst such a strategy protects the capital position of an insurer, this is often to the detriment of policyholders with the lack of exposure to more risky asset classes reducing the potential for customer upsides under profit sharing arrangements.

Yields on 10 year AAA-rated Euro area central government bonds



Source: ECB

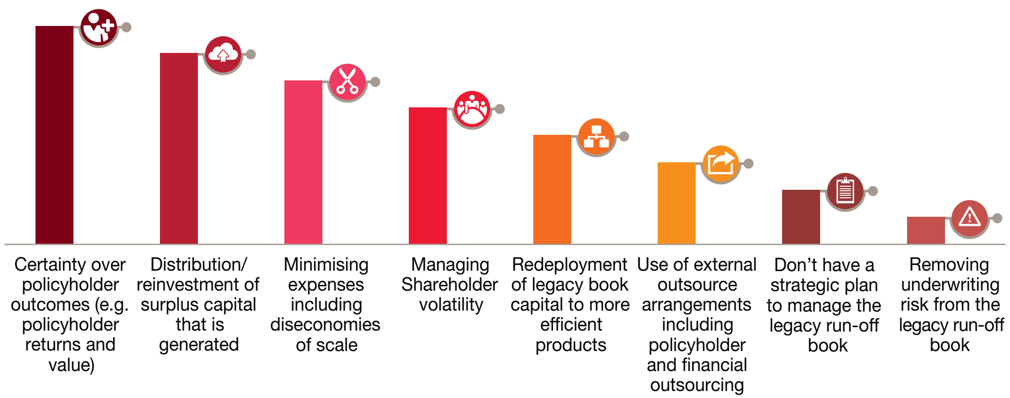
An alternative way to improve policyholder outcomes on such products is to convert participating policies with guarantees into unit linked business, enhancing policy values by the cost of guarantees, however, the cost to policyholders is the loss of valuable guarantees.

Without the constraints of high guarantees, firms are able to seek greater returns for policyholders at a reduced risk to shareholders, meaning policyholders are able to access an investment strategy which could yield a greater return and allow the company to free up valuable capital within the business, whilst reducing risks to shareholders.

Minimising expenses in a challenging environment

With such a challenging investment outlook, shareholder returns and value might be improved through maximising economies of scale and minimising the expenses of the business. The results of the survey show that minimising expenses remains high on the agenda for many firms, and is a significant driver of consolidation activity and management of cost cutting and efficiency programs. The principal challenges faced by insurers are nothing new, however, the changing regulatory environment has increased the cost burden on insurers across Europe as the industry has spent vast amounts of money in readiness for Solvency II and subsequently in ensuring appropriate disclosures.

What are the key objectives of your legacy/back book run-off plan? (Responses ranked high to low)



Source: PwC Survey

Minimising expenses in a challenging environment

In the short term, project spend is decreasing, however, significant outlay will be required by insurers to implement the changes required for IFRS 17. This represents a significant cost burden to the industry, with estimates as high as £3bn for the UK insurance industry alone, which is expected to be largely passed onto policyholders.

Reducing overheads and introducing greater levels of risk management, resulting in a simplification of governance structures, have been the mainstay of expense reduction programs over the past few years. Investing in better technology to improve automation in the administration process are leading to some insurers making significant cost savings.

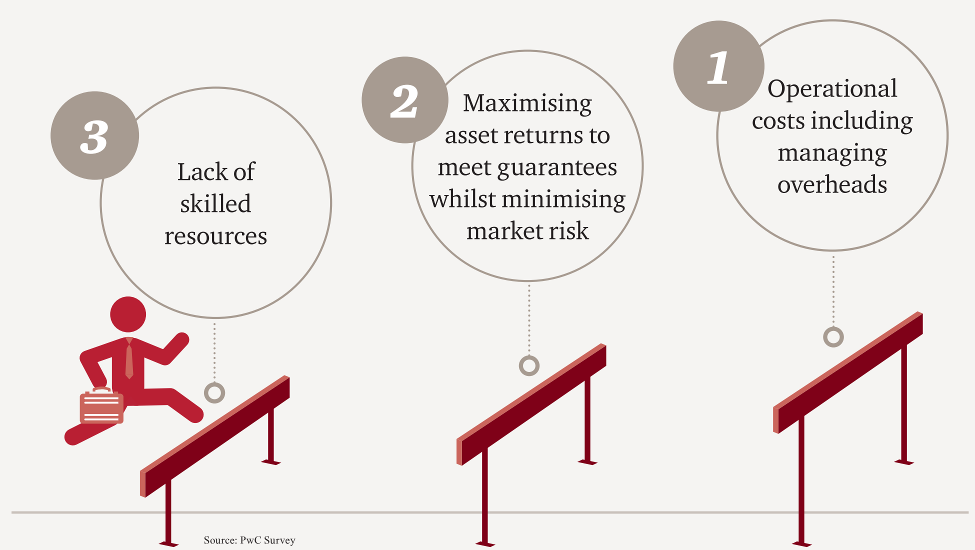
The lack of a sizeable outsourcing model in Europe does limit the ability of the traditional consolidators to replicate the models used in the UK. However, the market opportunity remains, and this isn't expected to prevent investment by ReAssure, Chesnara, Phoenix, or Resolution into the European market in the long term.

Lack of skilled resources

Participants of our survey have expressed lack of skilled resources to be a challenge. Over recent years, a key driver for this challenge is likely to have been Solvency II, with existing staff needing to be up-skilled to address the resource intensive regular reporting cycles. Further, companies who are aiming to optimise capital under the new regime, also seek additional ALM and investments specialists. Although Solvency II reporting is becoming a more efficient and slicker process for many firms, IFRS 17 poses another resourcing challenge, with the introduction of new profit recognition methods and models.

Companies going into run-off find it difficult to attract and retain skilled individuals within their business, given their aim to reduce costs as the business diminishes. This is exacerbated for some smaller insurers due to their geographical locations being away from financial hubs which often provide a pool of appropriate resources.

What are the top three challenges facing your businesses in managing legacy run-of business?

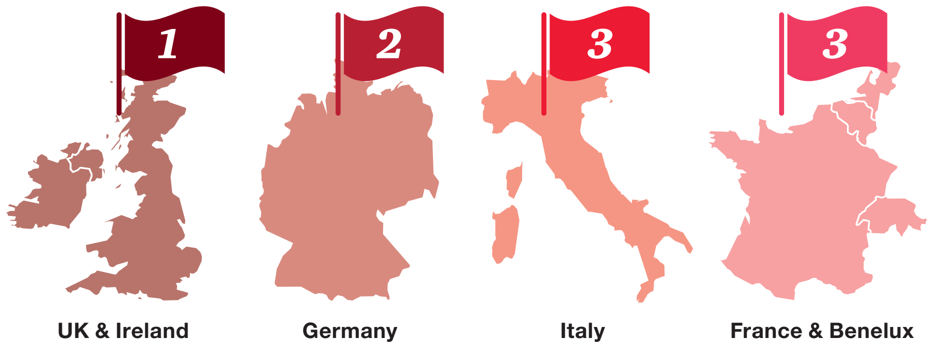


Source: PwC Survey

"As investors seek to diversify risk, the European closed life insurance sector offers the opportunity for good stable returns and an ability to deploy large amounts of capital. At the same time, closed life block consolidators are providing a solution to a sector facing the challenges of capital, administrative costs and low interest rates. The greater focus and freedom afforded to consolidators makes this sector very attractive "

Nick Page – PwC UK

Where do you see most activity occurring?



Source: PwC Survey

The results of our survey suggest that the UK insurance industry will continue to be the forerunner of M&A activity as evidenced during 2017, with the major European markets, specifically Germany, Italy and France expecting to see activity. We have examined each of these countries in more detail later in the report.

In recent years, large insurance groups such as Aviva and Generali have looked to redeploy capital from lower yielding non strategic assets into areas where greater returns can be achieved. The days of a large multinational insurer requiring a presence in every country across Europe therefore appear to be numbered.

For Aviva, life insurance businesses in Italy, Spain and the Isle of Man have been sold with capital returned to shareholders or redeployed to seek greater returns for shareholders. Similarly, Generali, has sold the Netherlands insurance operations to ASR and the German operations are subject to a reorganisation. Further activity is expected within other large insurance operations across Europe to free up capital for growing markets, which represents an investment opportunity for consolidators.

"The run-off market as a whole has historically generally flown under the radar of non-corporate investors, having traditionally been seen as an insurance restructuring, rather than investment strategy. M&A in the life run-off space will increase (following that of non-life) because of a combination of factors: awareness of the opportunity, significant 'dry powder' within global funds (which are also generally under-penetrated in insurance), the opportunity for higher returns in an environment of long term low global interest rates and competitive premium margins, and the 'forced driver' of Solvency II. This is a complex market, however – high quality management teams with focussed execution strategies will be in demand."

James Tye – PwC UK

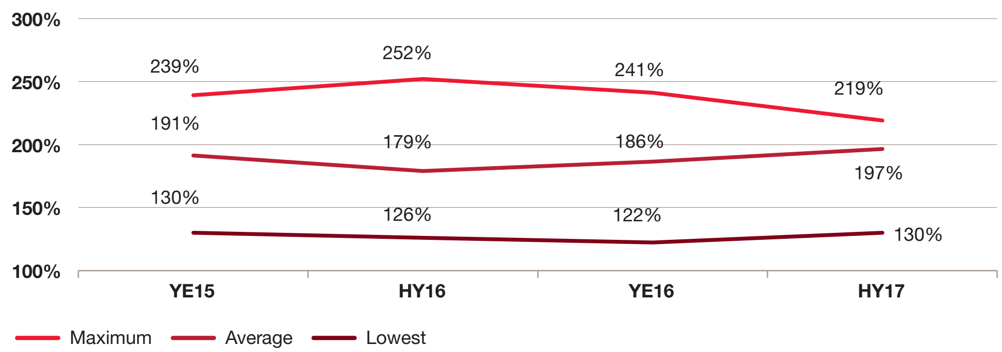
A new solvency regime and an opportunity to optimise capital

The nuances of Solvency II can be a source of additional volatility for some product types, which is being dampened by the effects of applying a transitional measures on technical provisions. Transitional measures therefore provide some protection to a business to solve a problem

The Solvency II balance sheet lends itself to areas of volatility. Some long-standing and inherent in previous reporting regimes, for example interest rates, others more specific to Solvency II, such as operational risk. These areas of volatility also introduce volatility in capital.

With the limitation of recognising future premiums through contract boundaries, new business strain is greater for certain product types under the new regime. Further, for insurers seeking matching adjustment eligibility, actual returns achieved on asset portfolios can differ significantly from spreads allowable in the matching adjustment, introducing volatility in the insurer's balance sheet and capital. Whilst there remains areas of volatility in the Solvency II balance sheet, the application of transitional measures for 16 years from the inception of Solvency II acts as a dampener for firms who use it.

Indicative industry solvency coverage ratio under Solvency II[2]



Which lines of business concern you the most?

Unit linked business

Savings with guarantees business

Deferred annuity business

Participating savings business

Inforce annuity business

Protection business

Source: PwC Survey

Deferred annuity business scored highly amongst survey participants as the most concerning area of business in Europe. The combination of high guaranteed annuity rates, longevity improvements, together with the low interest rate environment and a lack of very long dated assets make these products the most complex to manage. We continue to see businesses seek solutions to manage these risks, through longevity reinsurance trades, portfolio disposals and seeking much longer dated and alternative assets. Insurers are also increasing their capabilities around dynamic hedging, asset liability management and capabilities around understanding implication of investment decisions on capital and balance sheet volatility.

Long term guarantee package – The reliance on transitional measures and the matching/volatility adjustment is significant across Europe, albeit the impact in some countries is more pronounced than in others. A recent PwC study[2] showed that the solvency ratio across UK-based insurers would fall from 142% to 51% if these measures were not deployed, whereas for Italy, the solvency ratio would fall from 243% to 224%. For long dated products (e.g. deferred annuities, long term savings plans and in force annuities), a mismatch between the duration of the liability and the run-off of transitional arrangements provides a real challenge for insurers. Firms are therefore investigating different strategies to fill this transitional gap.

[2] Average has been calculated as a weighted average based on Solvency II Own Funds as at 31/12/2016. The insurers included in the chart are; Aegon, Ageas, Allianz, Aviva Plc, AXA, Generali, Just Group, Legal & General, Liverpool Victoria, Chesnara, NN Group, Old Mutual, Phoenix, Prudential, Rothesay Life, St. James' Place. Where ratios were not available, approximations were made.

Solvency II has resulted in significant change to the balance sheet and reporting requirements. The practical implications of the new regime are vast and have led to increased M&A and restructuring activity across the market.

The practical implications of Solvency II are wide-spread. However, there is an increased focus on risk management activity. Drivers of this include the increased capital requirements under Solvency II, as well as the inclusion of the risk margin in the liabilities.

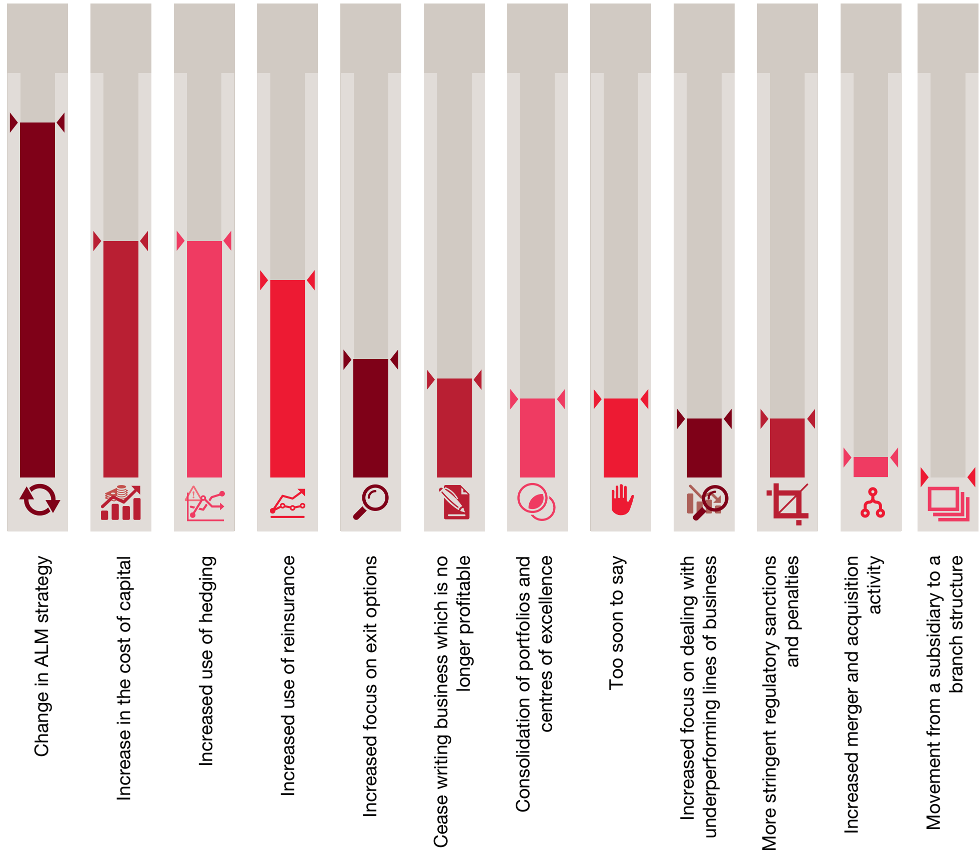
There has been an increase in reinsurance activity across Europe. Reinsurers are developing innovative solutions to help insurers to manage their risk exposures in light of the Solvency II capital requirements, including reinsurance of market and persistency tail risks tailored to solve particular problems. Mass lapse and lapse up/down protection is a new solution offered and some insurers are also exploring hedging the risk margin given the high 6% cost of capital required in the calculation. However, insurers need to be aware of the effects on counterparty and concentration risks as well as on effects on diversification as a result of reinsurance arrangements.

From a reinsurer's perspective, risks can be diversified more efficiently than by a sole insurance company, reducing capital requirements significantly. Apart from diversification from different types of products, reinsurers may also enjoy significant diversification from the geographical locations of their risks. An external reinsurer domiciled outside of the Solvency II regime but under an equivalent regime can also often benefit from a lower capital requirement.

"Insurers have spent large amounts of time and resources over recent years on implementing Solvency II and have had to overcome many of the practical difficulties of implementation. The next 18 months promises to be a time of change as insurers move away from the implementation phase into optimising capital and enhancing shareholder returns"

Steve Harrison– PwC UK

What have been the practical implications of Solvency II on life insurance books across Europe? (Responses ranked high to low)



Source: PwC survey

To date, the biggest change presented to insurers across Europe as a result of Solvency II has been the change to investment strategies. Traditionally, investment portfolios held by life insurers consisted of vanilla investments (e.g. local government bonds and unsecured corporate bonds). Solvency II removes any local restrictions on the assets that an insurer could invest in, and therefore introduces an opportunity for insurers to optimise their investment portfolio to increase capital efficiency and shareholder returns. There are often quick wins such as reducing concentration risk which can be implemented to reduce capital requirements.

Within the UK, restrictions imposed by the PRA on insurers to qualify for the matching adjustment have led firms to implement more strict investment criteria. For example, a fundamental change has been required to the structure of equity release assets to remove prepayment risk to make these qualifying assets. Further, the fundamental spread which feeds into the matching adjustment categorises by rating and duration, again influencing a firm's investment decisions and the choice of assets independent of achievable spreads.

Solvency II Equivalent regimes

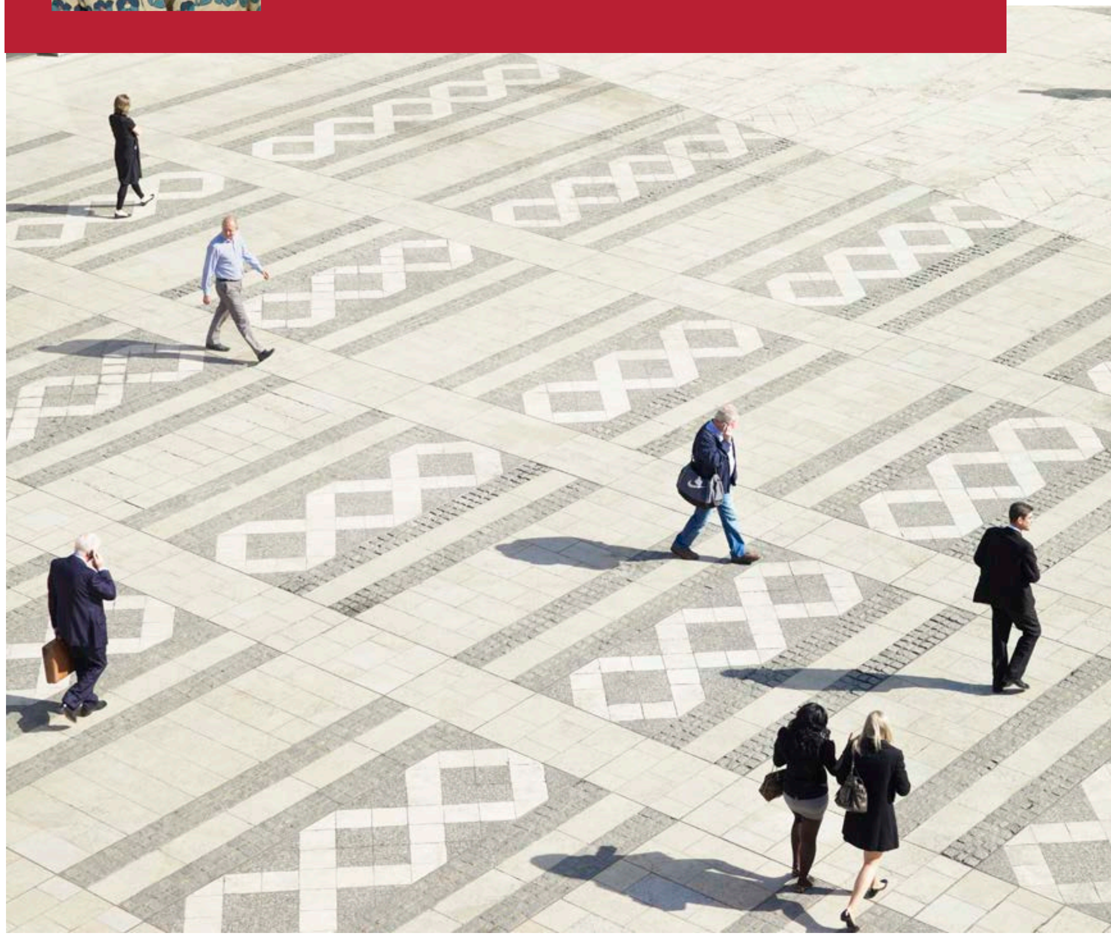
There are several regulatory regimes which have qualified for Solvency II equivalence, including Bermuda and Switzerland.

The Bermudan Solvency II equivalent regime is broadly the same as Solvency II. However there are some instances where capital requirements are less severe. For example, under the Bermudan credit stress, the calculations do not vary by duration and as such is less onerous for portfolios requiring longer-dated assets.

Conversely, the Swiss Solvency Test ('SST') uses a tail Value at Risk (VaR) approach, as opposed to the VaR prescribed under Solvency II. Further, the SST uses a Standard Model which in some respects resembles a simplified internal model under Solvency II. Although SST is more complex and requires more onerous calculations, the outcome of SST could more accurately capture a firm's risk profile and for certain risks lead to a lower or higher capital requirement.

"Optimising asset strategy, in terms of investment returns and regulatory capital, is absolutely crucial for firms to achieve their strategic objectives. We think the ability to source and structure alternatives to traditional credit investments is a key differentiator."

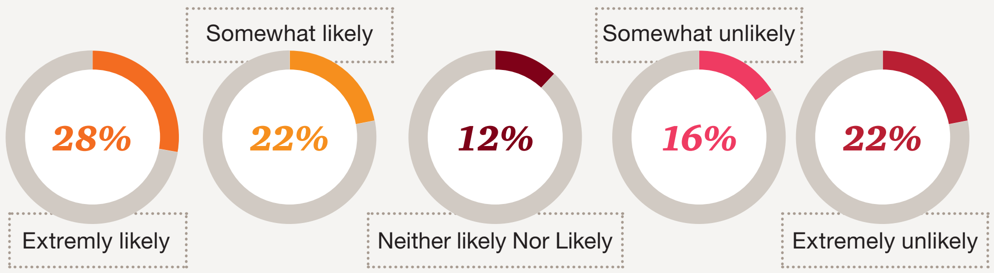
Shazia Azim– PwC UK



With Solvency II in place for two years, insurers are now starting to get to grips with what this means for capital and returns, recognising that there is an opportunity to optimise through more efficient use of capital with a wide range of tools available.

Our survey results showed that 50% of respondents expect some restructuring activity in the next 18 months. The sale of a book of business or full sale of an insurance entity is one of the last actions a management team will normally take when looking to restructure a business.

What is the likelihood of your business restructuring or exiting over the next 18 months?



Source: PwC Survey

Certainly, whether it is a board's intention to sell a business or not, identifying how to enhance the balance sheet in preparation for sale can help to increase the price to maximise value to a seller.

What are the tools for restructuring?

Source: PwC Survey

Restructuring tool kit

A range of different actions can be undertaken to enhance the value in a business ranging from quick wins, such as seeking to maximise the amount of diversification on a balance sheet and eliminating unnecessary concentration risk, through to much lengthier and more complex transactions such as merging legal entities.

We would expect many of these restructuring activities to lead to some form of transaction whether it relates to a business transfer, reinsurance trade, sale of a block of business or full exit. Restructuring and capital optimisation is typically just the start of the process.

Over the next few pages, we have examined the key markets across Europe where we will see the most activity in the coming years, our views as to the drivers of this and why this remains an opportunity.

UK life insurance industry – More consolidation to come

The UK industry is the largest and most complex in Europe, but specialist businesses such as UK annuity writers are growing quickly and providing solutions to take on liabilities that the larger multinational insurers no longer want. These businesses are more able to manage the risks of specific products and is leading to a more segregated industry where specialists are the key.

The UK life insurance market is large and complex, with c.£2,000 billion of mathematical provisions and a wide breadth of insurance products. The profile of insurers across the UK is varied, ranging from small mutuals, mono-line annuity writers up to large multinational organisations, each with differing goals and strategies.

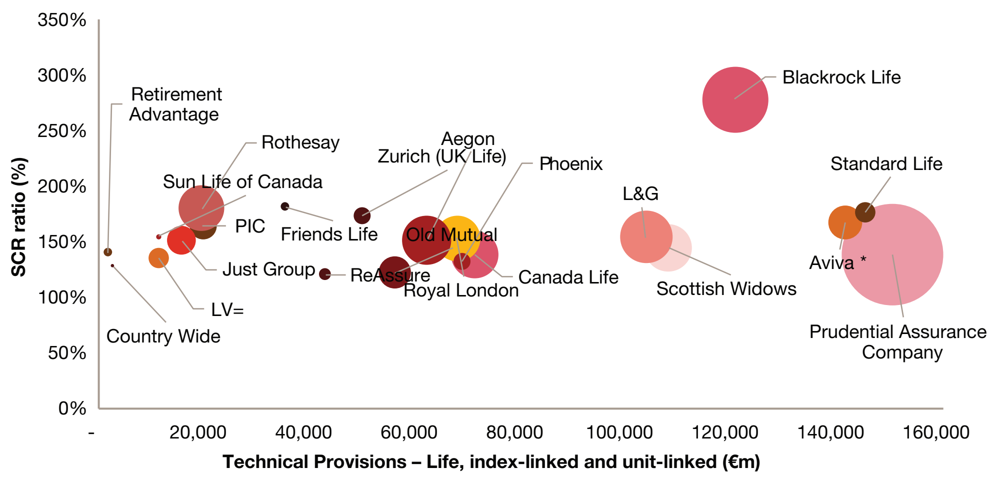
Further scope for consolidation

The UK market saw the birth of consolidation in the 80s through Century Life and Windsor Life who sought to acquire small insurance businesses, integrate functions and improve efficiency through outsourcing and generate shareholder and policyholder value through generating expense and tax efficiencies. More recently, consolidation activities have after increased, led by firms such as Resolution, ReAssure and Phoenix who took this consolidation to the next level.

The UK life insurance industry is still the largest in Europe and despite consolidation activity over the last three decades, it still has more insurance companies than any other industry in Europe. There remains scope for further consolidation and we expect further activity in the UK, within all sectors, but largely focussed on:

- The UK annuity market;
- Consolidation in the with profits sector; and
- Consolidation in the smaller UK mutual sector.

Figure of Solvency coverage ratio and technical provisions of UK life insurers



Source: PwC analysis

* Includes UK life entities UK L&P and Aviva Annuity business and excludes Friends Life (shown separately)

The UK annuity market

The dynamics of the UK annuity market have changed over recent years – With no compulsion to buy an annuity upon retirement, long-standing annuity providers have gradually exited from the market with a changed business strategy. For instance, Aegon, Old Mutual and Standard Life have focussed on building their asset management capabilities.

With the introduction of the pension reforms in 2014, low interest rates and the evolution of Solvency II, there has been a focus on the risk management of life insurers' large annuity portfolios.

Annuities are widely recognised as relatively capital intensive products and firms have used the following techniques to optimise their capital position:

Matching adjustment application

The matching adjustment offers a reduction in the overall capital held against annuities and insurers are exploring illiquid, matching adjustment eligible asset classes to maximise the benefit obtained from the matching adjustment. For instance, investments in loans secured on infrastructure, equity release mortgages and social housing. This requires specialist asset expertise and scale in the ability to source assets.

Sale of annuity portfolios

Some insurers have removed annuity books from their balance sheet through sale or reinsurance deals to free up valuable capital which is redeployed to other parts of the business. For example Aegon sold its UK annuity portfolio to Legal and General and Rothesay Life, where the proceeds have been reinvested into several strategic platform acquisitions of Co Funds and a portfolio of business acquired from Blackrock.

Longevity hedging/reinsurance

Transferring longevity risk off the balance sheet has historically been used to optimise capital position of the business. New reinsurance solutions examining credit reinsurance are now being explored by new entrants to the market.

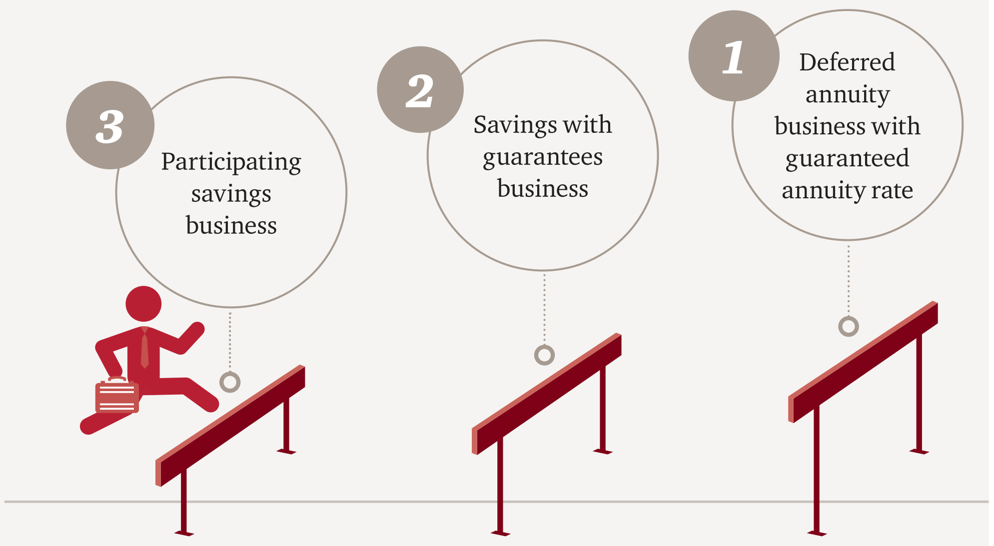
Market exit

Several large insurers, such as Prudential, LV and Standard Life, have opted to cease the sale of new annuity products. In addition, enhanced annuity specialists such as Just and Retirement Advantage, have had to take strategic decisions about their business in the face of a diminishing market.

There also continue to be bulk annuity deals offered across the UK market, with increasing numbers of pension schemes looking to life insurance companies as a way to secure payments to their pensioners and unburden their corporate balance sheet of legacy defined benefit pension scheme obligations.

PwC estimated that the value of defined benefit pension liabilities amounted to over £2,000 billion at February 2017, similar to the size of the UK life insurance industry. This is a huge market providing enormous potential for new business revenues and opportunities through bulk buy-outs and buy-ins. It is estimated that the size of defined benefit pension liabilities will halve by 2050. We also expect to continue seeing new entrants wishing to capitalise on this market opportunity.

What are the most concerning areas of your business?



With-profits continues to be a significant legacy business within the UK. These legacy issues are complex and specific to the UK participating business and require specialist skills. The number of companies willing to take on management of these types of business is decreasing but there remains scope for consolidation in this sector.

With-profits business in the UK

The UK with-profits industry with assets in excess of £350bn[3] is a market in decline. With-profit books are largely closed to new business and decreasing at a rate of between 5% and 10% per annum, with the volume of new business sales across the industry of less than £1bn per annum[4]. This is in contrast to the growth seen in other insurance sectors in the UK, such as the corporate pensions market which has benefited from auto enrolment. However, with-profits pension books have an increased opportunity to generate value through the pension freedoms introduced in 2014 which has opened up the range of retirement products available to customers.

In recent years Solvency II has been a focus for many companies with fewer resources and skills being developed and spent on managing with-profits business. With-profit funds tend to be more complex in nature with fewer people with the skills and knowledge to manage them. Deferred annuities with GAOs are a common feature of many with-profits funds. Challenges in credibility and availability of data can also limit the analysis that can be performed.

There continues to be consolidation in the with-profits sector, largely driven by mutuals and organisations seeking to generate capital synergies by simplifying their businesses with a recent example being the merger between LV= and Teachers Assurance. The drivers for consolidation continue to be capital and cost synergies for the acquirer, which is also generating increased benefits for policyholders from greater security and cost savings from economies of scale of moving into a larger organisation.

We expect consolidation to continue, but with Solvency II being set to move to a business as usual activity, companies are reinvigorating their management of with-profit funds and focusing on managing risks.

[3] Value of assets on UK realistic balance sheet (FY15 PRA returns).

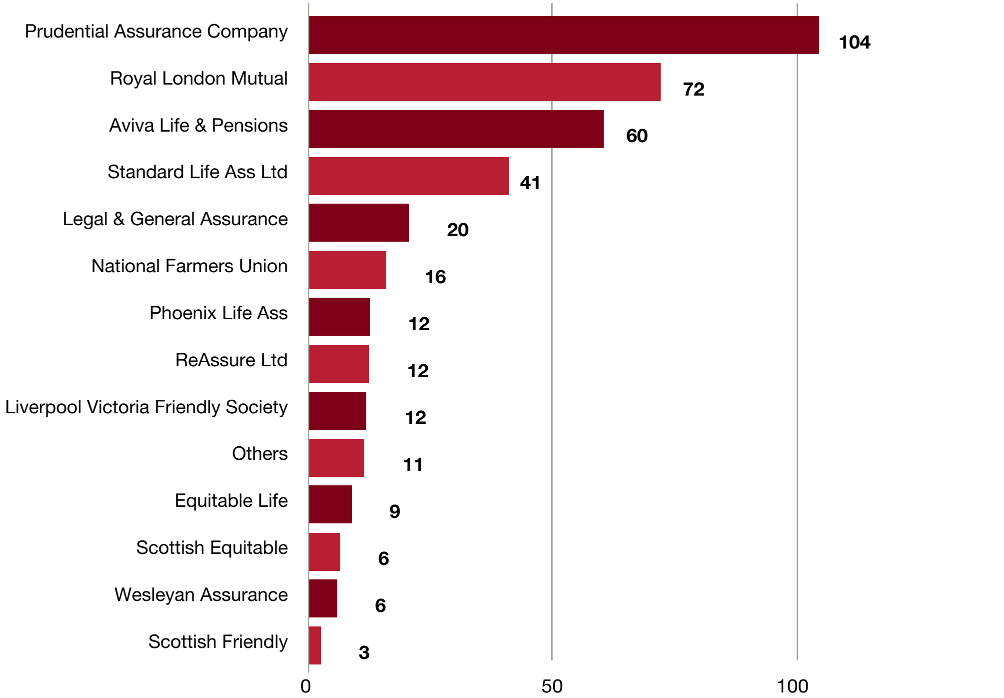
As with-profit funds continue to decline, insurers not only need to respond to the diseconomies of scale, they also seek to distribute the estate to policyholders and prevent a tontine. Strategies to manage the run-off of with-profit funds are nothing new, but freeing up management time following the implementation of Solvency II, means boards can now provide greater focus on optimising an insurance company under the new regime.

Activities laid out in the Principles and Practices of Financial Management (PPFM) of many with-profits funds such as buying out policy guarantees (Phoenix), unitisation (e.g. Sun Life of Canada – Cannon With-Profits Fund) and conversion from with-profits to non-profit (e.g. ReAssure – Alico and Sun Life of Canada – CLIC fund) are all tools that insurers will need to become more familiar with as these books run-off.

"Implementing Solvency II has required significant time and resources. Now there is a window of opportunity to revisit the strategic management of With-Profits such as goneaways and restructuring"

Kris Overlunde – PwC UK

UK With-Profits Fund Realistic Balance Sheet Assets



Source: PwC analysis

With-profits review

With-profits continue to be a focus for the regulator with the FCA in June 2017 issuing an information request to the majority of firms with with-profits business to help facilitate a multi-firm review of the sector. The review will focus on the fair treatment of existing with-profits customers. Although the details of the review have not been formally announced both the questionnaires and regulatory statements suggest the focus will be on how practices ensure customers have received a fair return in respect of smoothing and guarantees.

The review acts as a further reminder of the complex history of with-profits and any consolidation will need to consider potential implications of the review on a purchased with-profit fund.

German life insurance industry – An opportunity for consolidation

The German insurance market has started a phase of consolidation as external capital has begun to enter the market. The opportunity for consolidation is clear given the wave of insurers closing to new business and the stark low interest environment which makes writing traditional new business with guaranteed returns highly unattractive. For closed businesses, it appears to be entering a phase of 'consolidate or be consolidated'.

Historically, products written by life insurance companies in Germany (like many of their European counterparts) have been focussed on profit-participating endowment products. With the shift to more economic based pricing, products that insurers are willing to offer to customers are shifting from 'traditional' endowment policies where the insurer takes the investment risk, to unit linked or hybrid life insurance products where the policyholder takes on much more of the risk. This change however, has been slow as the new unit-linked life insurance products have fewer guarantees.

Legacy portfolios of German insurance companies contain products with high guarantees (sometimes up to 4% per annum) which in the current low interest rate environment means many of these products are significantly loss making on an economic basis.

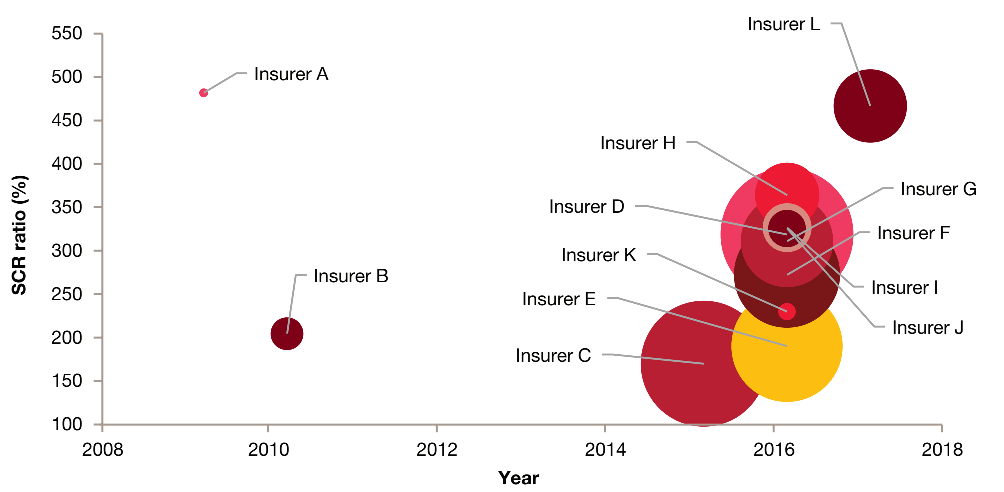
The prevailing low interest rate environment means that many insurers cannot continue to offer the investment guarantees which has led to some life insurance companies closing to new business. The prevailing maximum guarantee to be offered in Germany is set by the regulator, where the current guarantee rates offered being 0.9%. As of January 2017, a significant portion of the 87 life insurers in Germany have unofficially ceased to write annuity products with this guarantee. Insurers are preferring to stop writing traditional business or to cap the volume of traditional business that they write. Some insurers have also offered policyholders incentives to convert to unit linked products which require significantly less capital or hybrid products where significantly lower guarantees or charges for the guarantee are deducted.

In recent years, specialist run-off businesses have entered the German market, with invested assets managed by the these specialists currently around €21bn out of a total market of c.€900bn[4].

[4] We applied total gross earned premiums for PLUS, since the company's whole life business is in run-off and not only their classic business

This market is expected to grow significantly to between €100bn and €150bn in the coming years as the run-off businesses seek further opportunities to increase economies of scale and optimise the capital held within closed businesses. The major life insurers who have ceased writing new business now face a challenge as to whether to enter this competitive run-off landscape or be acquired by the specialist providers.

Major life insurers who have unofficially ceased writing new business for classic life insurance products



Source: BaFin, Assekurata, PwC Analysis, KIVI.

Consolidators in the German market

There are currently three established run-off platforms acquiring and administering life portfolios in the German market:

- **Viridium Group** with the Heidelberger, Skandia and Protektor portfolios;
- **Athene Germany Group**, which represents the former Delta Lloyd Germany Group (Delta Lloyd Leben and Hamburger Leben); and
- **Frankfurter Leben Group**, which acquired ARAG Leben AG and the life insurance portfolio of Basler Leben AG's German branch.

In addition, the ERGO business owned by Munich Re is expected to become the first intra industry player in the German life run-off market (due to the size of run-off business and the latest announcements regarding corporate strategy).

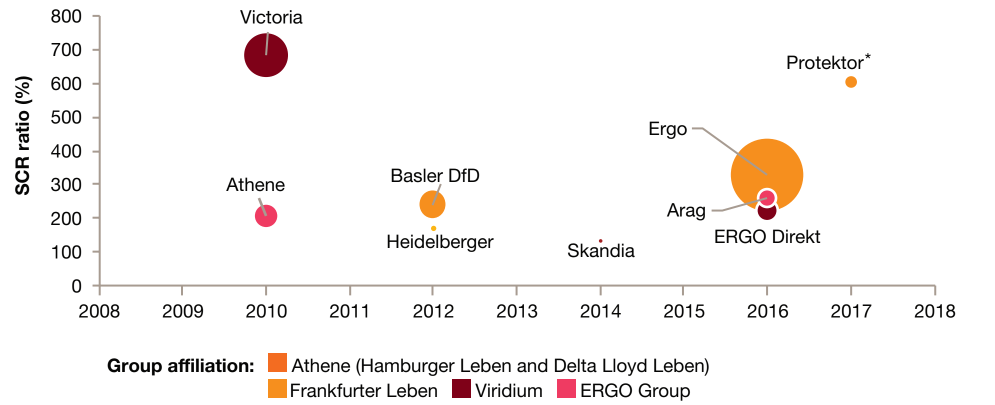
Strategic considerations for run-off

Despite the recent acceleration of run-off transactions in the German market, the portfolio transfer market in Germany is fairly underdeveloped and it will take time for pricing to evolve and the necessary expertise to develop. The products offered in Germany are relatively complex with many of the legacy products offering participation on investment, demographic risk and expense risk to the policyholder.

"The ongoing low interest environment compared with regulatory requirements (Solvency II and additional interest reserve) are likely to lead to an increasing run-off market which is expected to be attractive for specialist investors."

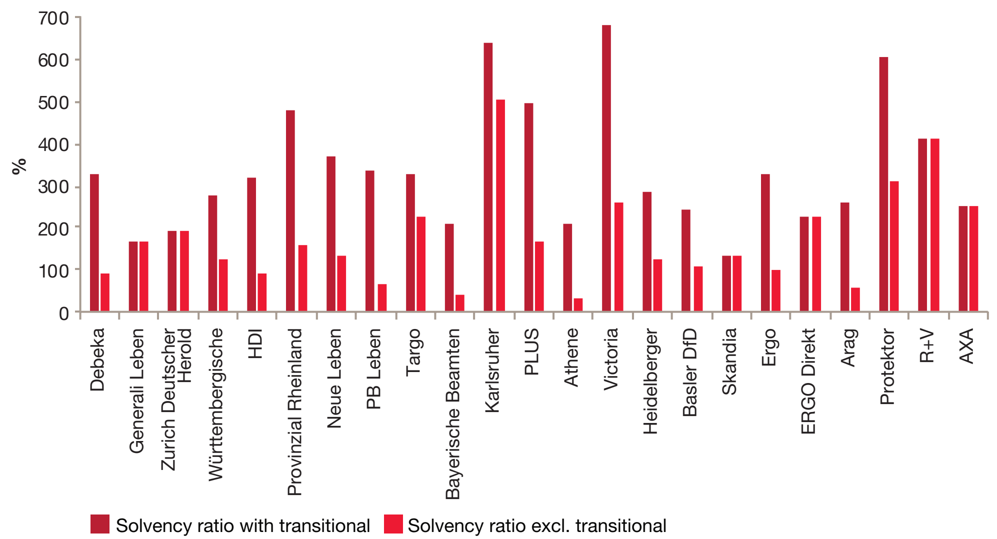
Christian Kern – PwC Germany

Present life insurance companies in run-off



* Protektor took over the portfolio of Mannheimer Lebesversicherung AG in 2003
Source: BaFin, PwC Analysis

Solvency coverage ratio with transitional and excluding transitional



Italian insurance market – A market facing challenging times

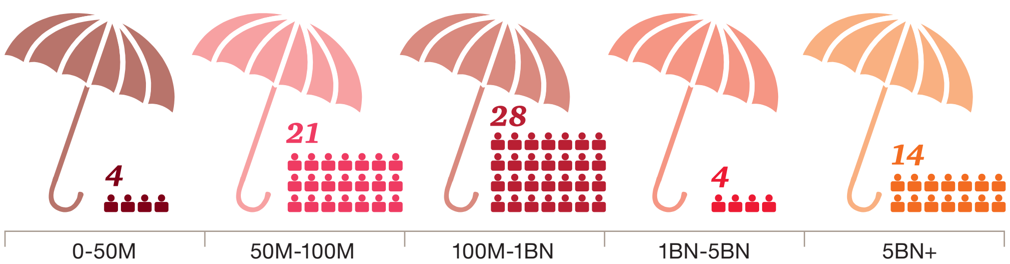
The Italian insurance market is a market in deep change, driven by historical issues from products with high guarantees and an economy with an expected growth in the short to medium term, that is expected to be lower than the European average. Efficient management of the back book to extract more from the existing business will be critical as insurers need to generate capital efficiencies and a return for shareholders.

Italian market overview

The Italian insurance market is dominated by five large insurance groups (Generali, Poste Vita, Intessa SanPaolo, Allianz and Unipol) with a total market share of 62% by GWP. The majority of products sold were traditional participating life insurance contracts with high guarantees. However, there has been a change to reduce volumes in order to limit the guarantees to a return of the initial sum invested. The business model is largely focussed on distribution arrangements via the bancassurance model, with large insurance groups having distribution arrangements with many of the regional banks of Italy.

Life sales were down 11% in 2016 relative to 2015 as the economy in Italy continued to experience small levels of economic growth. The life insurance industry in Italy is now facing a challenge from customers who demand traditional participating insurance contracts with guarantees versus a back drop of these contracts typically being uneconomical to write once the value of the guarantee is captured.

Number of life insurers by annual gross written premium



Source: PwC Analysis

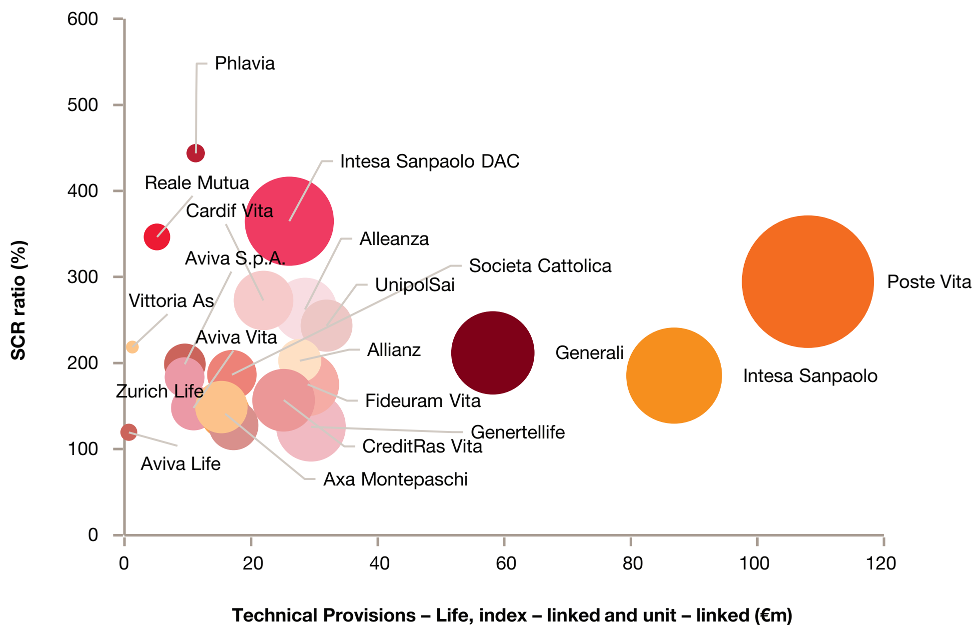
Many life insurers in Italy are therefore seeking to move to offering unit-linked style products where the customer takes the investment risk which makes the products much more capital efficient for the insurer.

There continues to be a large industry within Italy by premium volumes, however, many of the insurers are sub-scale and further consolidation is likely to happen in particular within the companies writing less than €1bn GWP per annum.

Solvency – Starting from a position of strength

The Italian insurance industry appears to be in a position of strength relative to others around Europe. The diagram below shows the distribution of strength versus technical provisions and gross written premium.

Major life insurers in the Italian insurance market



Source: PwC Analysis

The Italian life insurance market showed an average Solvency II ratio (Eligible Own Funds over Solvency Capital Requirement) of 210%. The industry to date has limited use of transitional arrangements with the exception of the use of the volatility adjustor, which is in stark contract to the use of such transitional measures in the UK and other large insurance markets across Europe.

The Own Funds (and so the Solvency Ratios) of Italian life companies continue to be subject to high levels of volatility due to the wide spreads on Italian government bonds in which segregated funds are heavily invested. The current volatility adjustment methodology doesn't help too much to reduce this effect, as an anticyclical measure should do.

The large insurance operations such as Generali and Poste Vita have strong capital positions, and they are now looking at redeploying capital to other markets

Where have deals happened

M&A activity in the Italian life industry is continuing with several transactions focussed on large foreign insurance groups (such as Ergo, Old Mutual and Aviva) exiting the market, bancassurers selling insurance operations to private equity firms and the early development of a closed business consolidator.

Date	Target	Acquirer
2017	AviPop Assicurazioni S.p.A *	Cattolica
2017	Popolare Vita S.p.A	Cattolica
2017	Eurovita Assicurazioni S.p.A	Cinven – Phlavia
2017	Uniqa	Reale Mutua Group
2016	Old Mutual Wealth Italy S.p.A.	Cinven – Phlavia
2016	C.B.A. Vita S.p.A.	HDI Assicurazioni S.p.A.
2016	ERGO Previdenza S.p.A.	Cinven – Phlavia

Source: PwC Analysis
* Avipop Assicurazioni S.p.A. owns 100% of Avipop Vita S.p.A.

What is the future for the Italian industry

There has been little activity to date that has been driven by businesses looking to restructure and optimise their capital position, which is likely to be an area of future activity. The development of the run-off market particularly with the Phlavia vehicle established by Cinven and Carige established by Apollo Global Management would appear to give Italian insurers an opportunity to dispose of blocks of business in their back book that are capital intensive, allowing insurers to focus on distribution and new business growth.

Partnerships are also changing within the market landscape with the recent acquisition by Cattolica from Aviva that brings within the insurance group the control of two life insurers (Avipop Vita is 100% controlled by Avipop Assicurazioni) and one non-life insurer.

New investors in the run-off market are also expected to enter and provide solutions to the historic problems that are still providing a drag on capital for the larger insurance operations.

"The small size of many insurers does not help them to meet capital requirements arising from the existing business, so further consolidation is likely to happen via M&A activity"

Flavio Fidani – PwC Italy

French life insurance industry – A market waiting for consolidation but dominated by the bancassurers

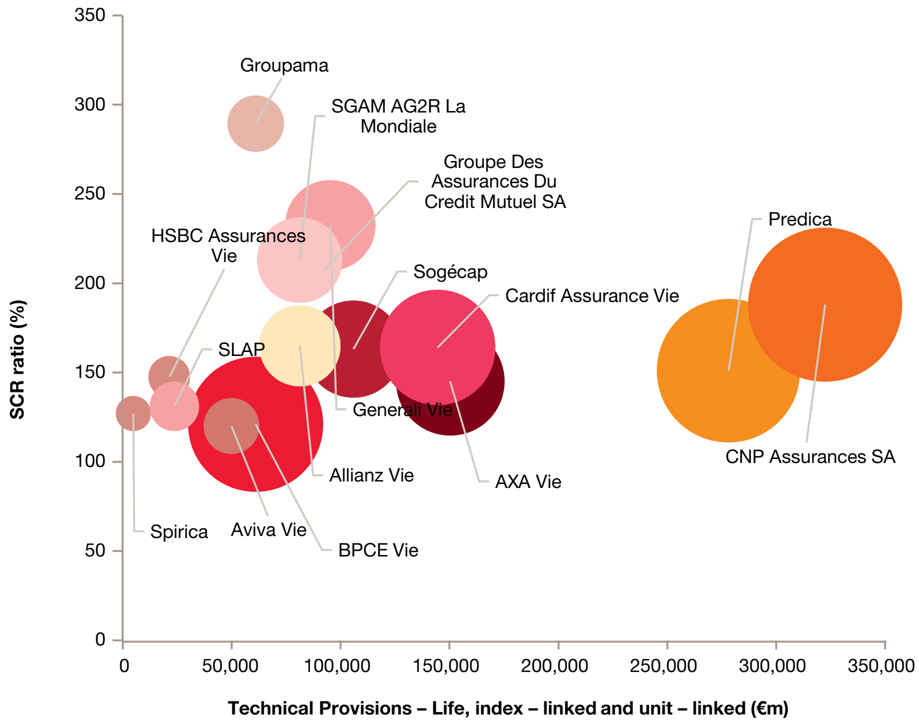
The changes introduced by Solvency II are a turning point in the run-off industry but the life run-off market is expected to be slow to gain momentum and the regulatory environment appears less favourable to external investment.

Life insurance companies in France (like many other European markets) have historically been focussed on profit-participating endowment products, as they were yielding superior (4% and more) returns to the policyholders in a tax-friendly long term wrapper. The technical provisions of life insurance policies now amount to more than €1,591 bn[5] (of which 17 % are unit-linked) excluding the risk margin. The French market remains quite concentrated with 90% of these reserves owned by 16 groups. However, there remains a large number of sub-scale insurers in the industry.

Most of these legacy portfolios are not closed to new money as policyholders have contractual rights to continue paying premiums at legacy guaranteed rates of interest. The persisting low interest rate environment across Europe is therefore leading to a continued capital drain on the resources of many life insurers in France.

New products are now largely focussed on unit-linked products with customers accepting the investment risk and the insurers taking a basis point fee. The Autorité de Contrôle Prudentiel et de Résolution (ACPR) has recently granted insurers to market life insurance policies with a 0% financial guarantee expressed gross of charges, meaning that the capital is not totally guaranteed on a net basis in a negative or very low interest rate environment due to the loadings and management expenses that apply. However, the change in demand for the new style products is slow in take up, as policyholders are continuing to expect products with high guarantees. Lapse rates for the legacy products are low, with the crystallisation of tax benefits on specific policy anniversaries often a driving force of policyholder behaviour.

Figure of solvency coverage ratio and technical provisions of French life insurers (excluding mutuals)



Source: PwC Analysis based on public disclosures.

[5] Fédération Française de l'Assurance.

The difficult breakthrough of run-offs in France

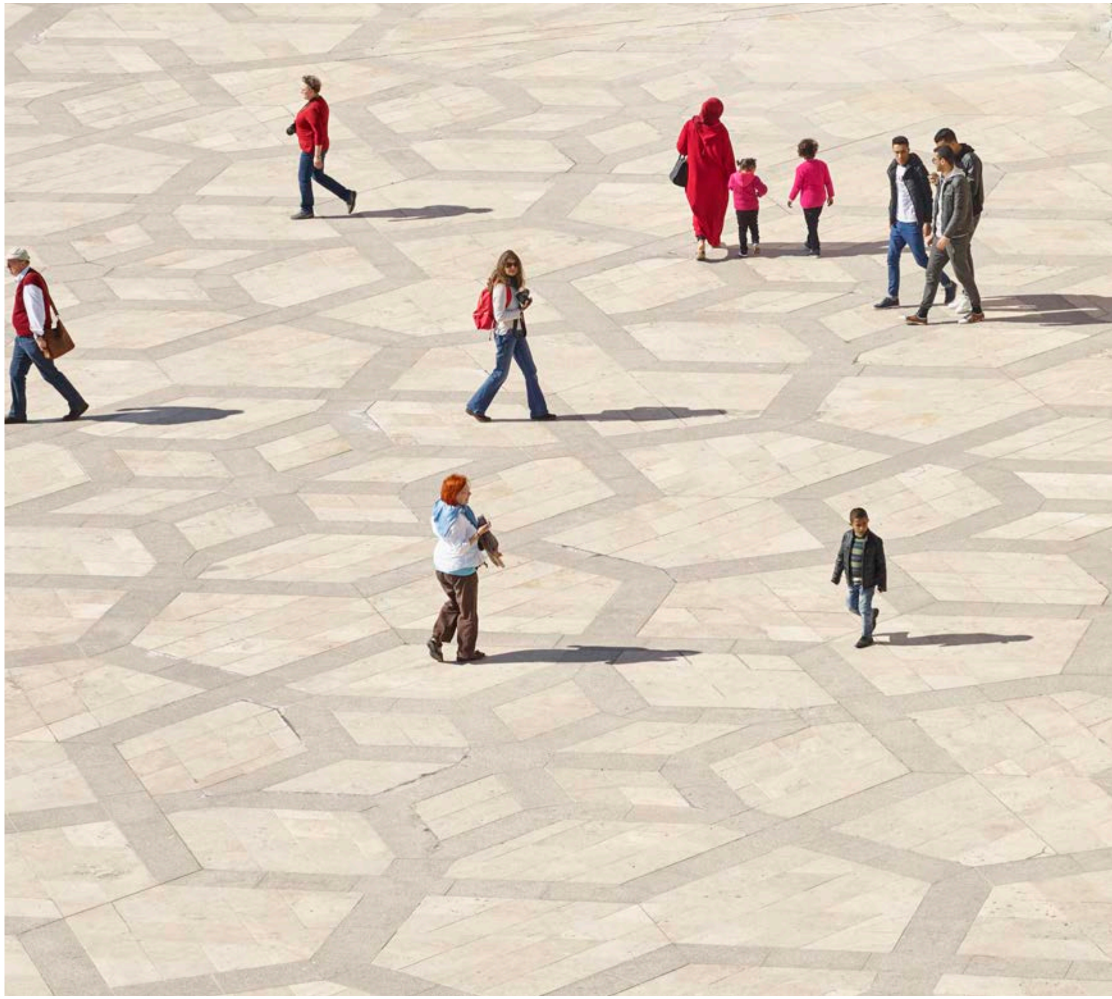
The French insurance industry is diverse with three main types of life insurance vehicles driven by distribution channels.

- Bancassurance sector with sales forces pegged to the banking networks (e.g. Credit Agricole, BNPP, Societe Generale, BPCE)
- Large life international insurers with sales via Independent Financial Advisors (IFAs) (e.g. AXA, Allianz, Generali)
- Mutual life insurance companies (e.g. Groupama, Covea)

The bancassurance and mutual sectors have long-term relationships with their clients, with whom product cross-selling (banking networks) and affinity relationships (mutuals) are the key to sales volumes and to maintain persistency.

For the bancassurance sector, commission accrues to the bank via the salesforce increasing the value of the insurance business to the bank, and enhances the new business proposition. The bancassurance sector in France remains very strong and there is likely to be a limited appetite for any form of run-off of the businesses, especially for life and savings products where the new business pipeline remains strong due to the insurance products differing to those offered by the bank. However, as the bancassurance industry tackles the changes in valuation of life insurance assets on their balance sheet resulting from changes in Basel 3, this may trigger some limited activity amongst the smaller bancassurers.

The larger international life insurers, such as Allianz and AXA, are unlikely to see an exit from the profitable French market as part of their ongoing strategy. However, in line with other multinational insurers, an exit from unprofitable business lines remains a possibility, which may yield activity in the run-off market.



Within the mutual insurance sector, strong customer relationships are the key driver for new business sales and persistency. However, the size of insurers in the mutual sector is much smaller and therefore the ongoing regulatory burden is likely to trigger some consolidation. For instance, with strategic decisions to completely exit from savings product offerings.

Initial consolidation activity is therefore likely to be focussed on specific portfolios or blocks of business as companies seek to better optimise their capital position and may be focussed on externalisation of administration, reinsurance and solving specific problems within a portfolio. The ACPR however, is likely to examine any transaction with a high degree of scrutiny to avoid negative implications and mismanagement for the end-customers and their guarantees.

Further market activity on the back of the transfer of large books of annuities to newly created segregated occupational pension funds ('FRPS') is also likely to occur, following changes in regulations that allow a less onerous capital treatment and in some circumstances an exemption from Solvency II. Large corporations are actively considering this option which may facilitate some activity in the annuity space in the near future.

"The French run-off market hasn't yet bloomed, but the market conditions are now favourable and several products have paved the way for future developments."

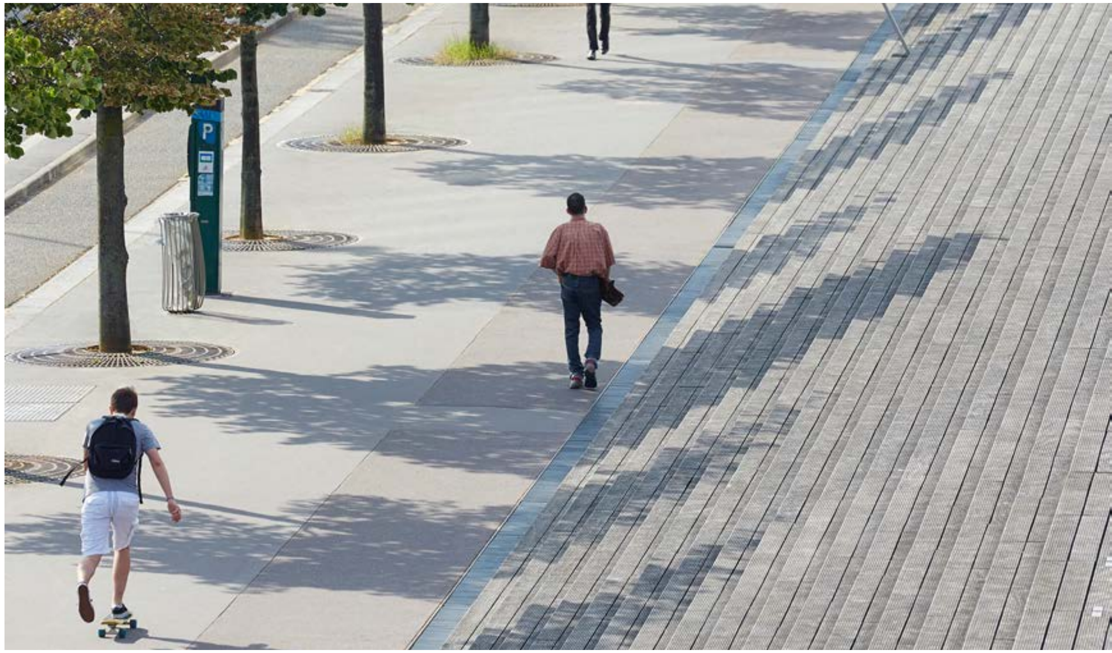
Francois Beugin – PwC France

Where have deals happened

2013: SMA Vie BTP acquired the life portfolio of Metlife France as part of the global relocalisation of MetLife's European businesses to Ireland (ACPR prescribed).

2014: Optimum Vie acquired Malakoff Mederic Epargne to increase its market share of the French Insurance market leading to the exit of Malakoff from pure savings products.

2015-2017: Several intragroup portfolio transfers have occurred within mutual and provident groups as a result of local falls in solvency coverage ratios.



Dutch life insurance market – Current activity and trends

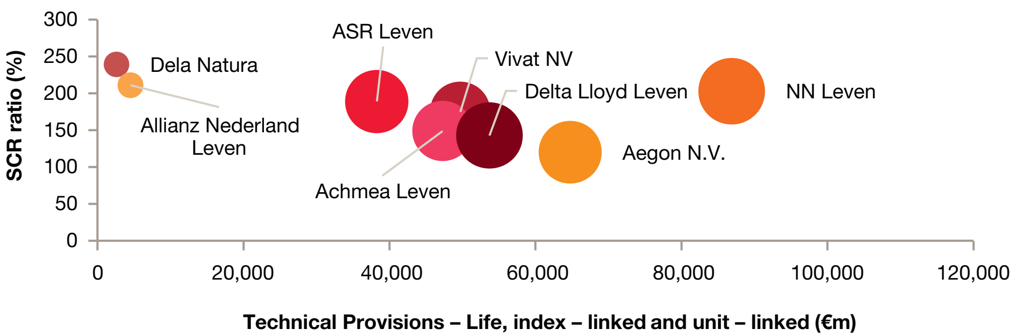
In the Netherlands, most Dutch insurers are currently in the process of considering the different strategies depending on the size of their closed books. Only a limited number of insurers have actually started to implement a strategy to face the challenges of a closed book.

The Dutch life insurance market is mature and saturated, characterised by fierce competition and price-pressure due to contracting demand for individual life and traditional group life products. Along with a low interest rate environment and increasing life expectancies, Solvency II has driven Dutch insurers to focus on capital efficiency and effective legacy book management. In addition, the mis-selling of unit-linked policies (Woekerpolis) has led to reputational damage and risk of additional claims.

Competition from banks through the sales of tax sheltered banking products has also led to lower new business. As a consequence, the profitability of Dutch insurers has been under pressure for several years, with some Dutch insurers closing to new business in recent years.

The main challenge of closed books is managing rising costs per policy as volumes decline. This is often driven by the large fixed cost base (for instance due to operational systems) that do not decrease with policy volumes. Another challenge is maintaining a good but modern customer service, and staff retention. A deterioration in customer service can cause more policyholders to lapse their policies, which further increases the cost per policy. Continuing focus on customer retention is therefore key for any closed book insurer.

Figure of SCR ratio and technical provisions of Dutch life insurers



Source: PwC Analysis

Whilst some Dutch insurers have focussed on selling their closed books, others have worked to improve the retention of their book by focussing on reducing costs in order to improve their profitability. We have seen insurers adopt one or a combination of the following strategies:

- Focus on cost reductions through 'Lean' programmes, process standardisation and data quality improvements.
- Outsourcing of administration and/or legacy IT systems to third parties. This effectively converts a large fixed cost base into a more variable base, helps increase focus on new products and improves service quality levels (subject to close monitoring) and customer satisfaction. However, insurers should not ignore the significant costs of IT migration together with any redundancy and staff transfer costs.
- Acquisition of closed books. Through the acquisition of closed books economies of scale can be achieved reducing the cost per policy.

Where have deals happened

Deals activity in the Dutch market is rather limited relative to other European countries. The most notable market activity was an acquisition of c.€2.5bn (79.9%) stake in Delta Lloyd by the NN Group late last year, driving further market consolidation, the recent sale of the Dutch insurance operations of Generali acquired by ASR and Chesnara acquisition of L&G's Dutch insurance operations.

Speculative reasons for the slow deals activity could be due to the fact that insurers are awaiting a final ruling from the courts on the mis-selling of unit-linked policies. In addition, under Dutch law, a transfer of liabilities requires policyholder consent which is relatively cumbersome and costly to achieve.

"To reverse the effects of declining portfolio sizes, Dutch insurers plan to increase their new business volumes in many products, including mortality and non-life products. We expect to see strong competition in the market in the coming years."

Bas van de Pas – PwC Netherlands

Valuation in the life insurance market

Since the inception of Solvency II, we have seen more companies moving towards a multiple of Solvency II Own Funds as a key pricing metric. However, a regulatory view of the world can significantly under or over value an asset depending upon the types of products written, value ascribed to the franchise and the use of regulatory tools such as the volatility adjuster and transitional arrangements.

Our survey suggests that businesses still value MCEV with 24% of businesses continuing to use this metric, however, 33% of respondents are now using Solvency II as the key metric. Dividends and cash generation is used by 38% of respondents, but the underlying basis for determining dividends is restricted by the Solvency II capital.

Since the inception of Solvency II, we have seen a reduction in the number of large insurers publishing Embedded Value (EV). Many insurers such as Aviva, Legal and General and Old Mutual have stopped publishing EV on their in-force business, although some such as Allianz and many of the bulk annuity writers such as Rothesay Life and PIC continued to publish EV disclosures at YE16.

The Value of New Business (VNB) written each year, continues to be disclosed throughout the industry using an EV type measure due to the lack of a Solvency II specific equivalent. In May 2016, the CFO Forum published amended MCEV principles to provide further guidance for insurers wishing to incorporate Solvency II in their MCEV. This resulted in a variety of different approaches across the market around the adoption of Solvency II within MCEV calculations. The amended principles also introduced more flexibility around disclosure requirements than under the previous principles.

Although many insurers continue to calculate their EV internally either regularly or on an ad hoc basis, publically available EV is decreasing, and making comparisons between companies is increasingly difficult particularly in light of the changes introduced by the new principles. In contrast, insurers must publish their Solvency Financial Condition Report (SFCR) at group level, with sub disclosures in respect of each insurance entity in the group for the first time at year end 2016. The comparative transparency and consistency in calculation methods have driven SII Own Funds to be an important starting point for pricing insurance deals. However, it is important to remember that Solvency II Own Funds are only a regulatory view of the surplus assets in a business with various limitations, which may make it unsuitable as a pricing metric without adjustment.

Some of the key adjustments to be made include:

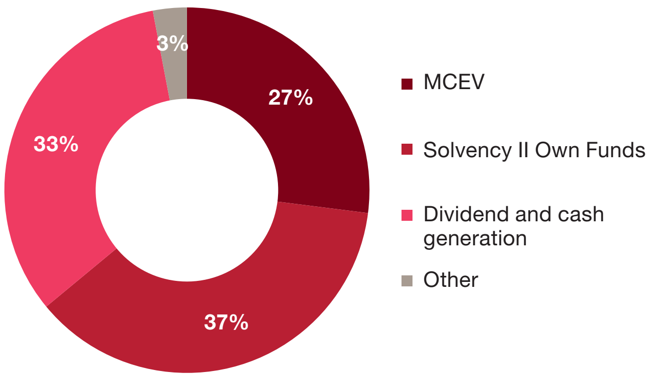
Contract boundaries are most commonly applied on unit-linked products and restrict the value of future premiums that can be included in the calculation of the best estimate liability, and subsequently the regulatory balance sheet. Under an economic view of the world, there are no restrictions over the recognition of such future premiums, and therefore an EV measure includes the real value of profits beyond the contract boundary, and therefore represents real economic value to an investor.

Regulatory Own Funds includes assets backing a participating ring fenced funds SCR, which is ultimately policyholder money. An adjustment would therefore be required to exclude this value.

The **matching adjustment** used to adjust the discount rate applied to annuity business is calculated based on EIOPA published fundamental spreads. This is a regulatory view of the liquidity premium on an asset, which may not reflect an investors view of the liquidity premium that could be achieved. The matching adjustment therefore may understate value relative to an investors liquidity premium and would exclude returns on illiquid assets outside an MA portfolio.

Adjusting the Own Funds to a quasi Embedded Value to reflect the additional value to an investor therefore continues to be an important consideration when assessing value.

What is the key metric for pricing deals



Source: PwC Survey

IFRS17

IFRS 17 will fundamentally change the accounting by all entities that issue insurance contracts and investment contracts with discretionary participation features. The standard applies to annual periods beginning on or after 1 January 2021.

Acquirers of insurance companies need to consider the impact that IFRS 17 will have on exit mutliples when pricing deals.

In recent years, closed life deals in the UK have multiples slightly lower than 1x EV. Recent examples of closed life transactions in the UK are the acquisitions of Abbey Life and AXA Sun Life by Phoenix Group which were priced at 0.71x and 0.77x respectively. The corresponding multiple of Solvency II Own Funds were 0.85x and 0.89x respectively. There are various reasons for a discount to be applied to the EV or Solvency II Own Funds, not least reflecting an investor's required rate of return on the cost of capital, adjustments for mis-selling provisions, adjusting for an acquirer's view of the underlying assumptions of the business and generally reflecting the uncertainty within a business plan.

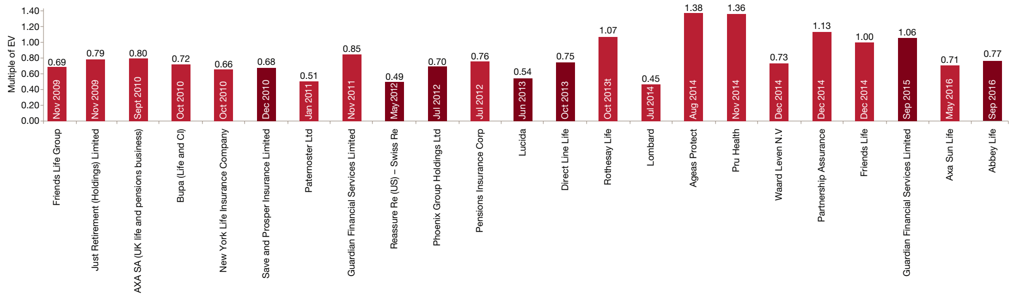
For open books of business, prices are typically in the range at 1.1x to 1.4 x EV, which we consider to largely reflect new business or franchise value driven by a strategic decision to enter a market.

Since the inception of Solvency II in 2016, the observed range of multiples of SII own funds across transactions across Europe ranges from 0.49 to 1.33 of Own Funds. The multiple of Own Funds applied is heavily dependent on the nature of the business, with large books of unit linked business likely to be traded at a premium to Own Funds because of the loss of value on the regulatory balance sheet from the application of contract boundaries (for example, the acquisition of Old Mutual Italy by Cinven (at 1.16x) has strengthened its presence in the Italian unit-linked market through existing ties with distribution channels in the market). For businesses with large participating books, a discount to regulatory Own Funds may apply due to the elimination of Policyholder surplus funds. Other drivers for a premium to Own Funds could include the brand strength or Franchise value, or a payment in anticipation of future capital or operational synergies that could be achieve by a business.

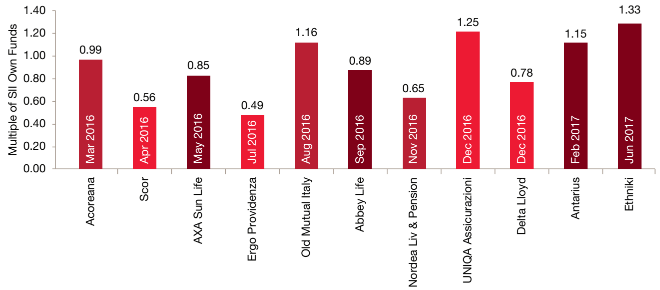
"We would expect an acquirer to use Solvency II Own Funds as a starting point for the valuation of a life insurer, however, a number of significant adjustments are likely to be required to reflect the true economic value of the business, and whether capital can actually be paid to shareholders or remains trapped within the business to support the inforce book."

Julie Pallister – PwC UK

Multiple of EV to price of recent transactions



Multiple of SII Own Funds to price of recent transactions



SII own funds are without any applicable transitional measures

Source: PwC analysis, public disclosures and information

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Notes

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