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2014 Outlook - Global Life Insurance

Scope for a Smoother Environment Amid Higher Interest Rates, but Noteworthy Risks Remain

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2014 Outlook – Global Life Insurance – Stable

Outlook Key: NEGATIVE | STABLE | POSITIVE

Key Credit Issues

- Interest rates are low but are rising
- The slow pace of recovery for the global economy
- Uncertainties arising from evolving global regulations

STABLE

Downside risks

- Persistently low interest rates
- A sharp increase in rates
- A revival of the sovereign-debt crisis

Key drivers (2014-15)

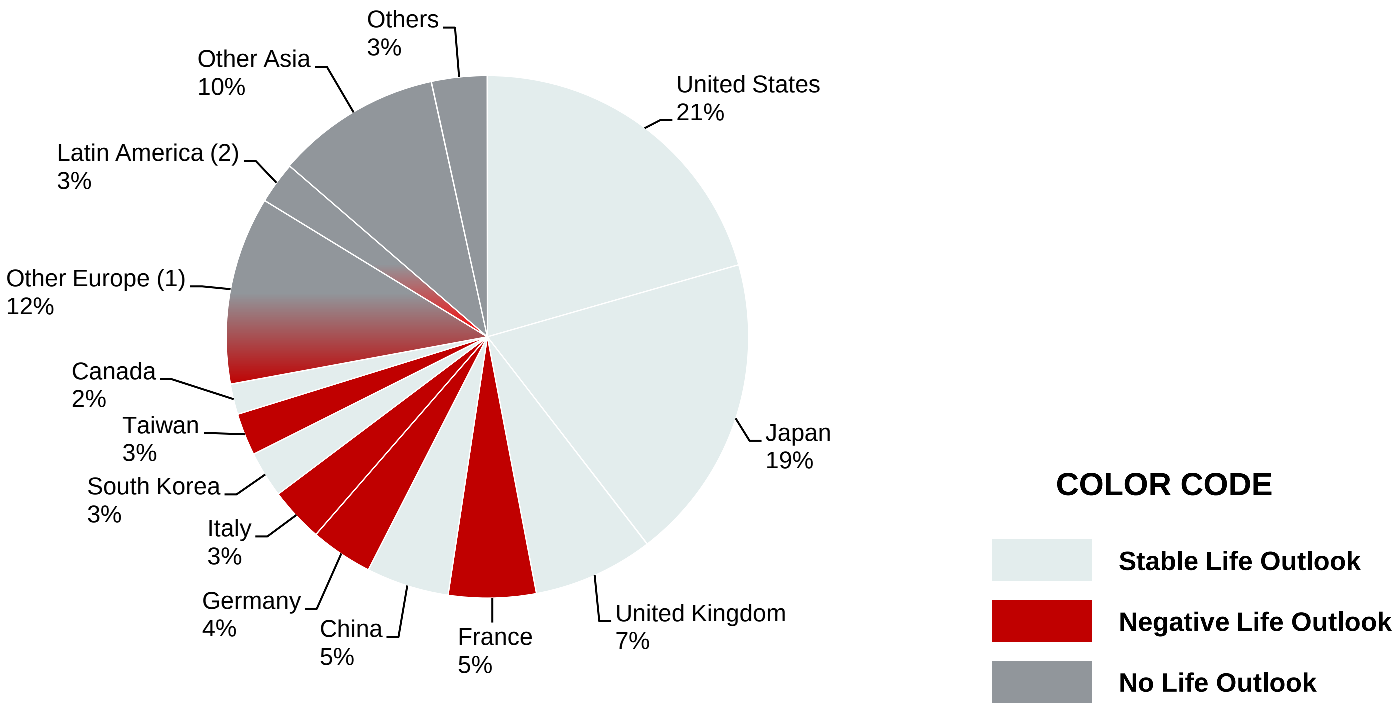
- Amid gradually rising interest rates, we see a diminishing risk for a decline of insurers' investment yields below the level of policyholders' guarantees. Slower rate of decline in investment yields.
- Reduced pressure on sales against backdrop of a nascent global recovery and relative overall stability.
- New regulatory frameworks will be developed in 2014, creating uncertainties. Impact on insurers will be limited initially.

Supportive factors

- A smooth and steady increase in interest rates
- Sustained improvement in the macro-economic environment

Regional Life Insurance Outlooks Overview

Breakdown of 2012 Global Life Premium Volume (total premium = USD 2.6 trillion)



(1) Includes The Netherlands (negative outlook)

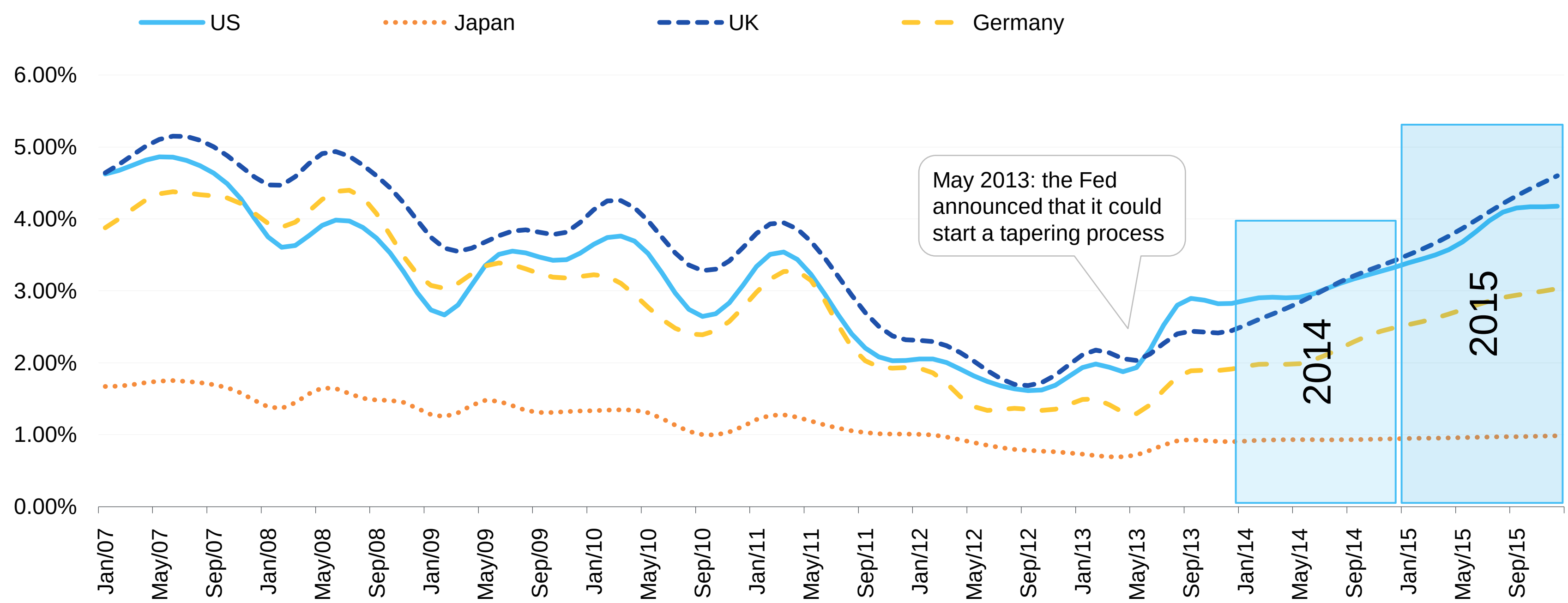
(2) Includes Brazil (stable outlook), Mexico (stable outlook), Argentina (negative outlook), Bolivia (negative outlook)

Sources: Swiss Re, Sigma, World insurance in 2012 Progressing on the long and winding road to recovery, 2013 ; Moody's Investors Service

1. Interest rates are low but are rising (1/5)

Interest rates will remain low by historical standards, but we expect them to rise gradually in 2014 and 2015, with some signs of divergence by geography

10-year government bond yield



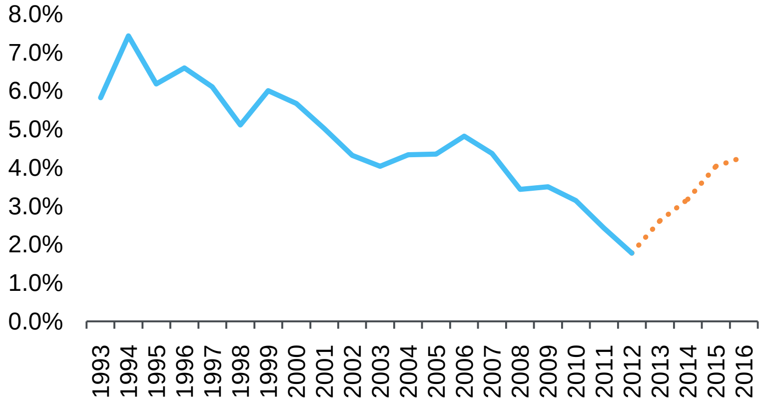
Sources: U.S. Board of Governors of the Federal Reserve System (FRB); European Communities, EUROSTAT; International Monetary Fund (IMF); Moody's Analytics Forecast; Moody's Investors Service

1. Interest rates are low but are rising (2/5)

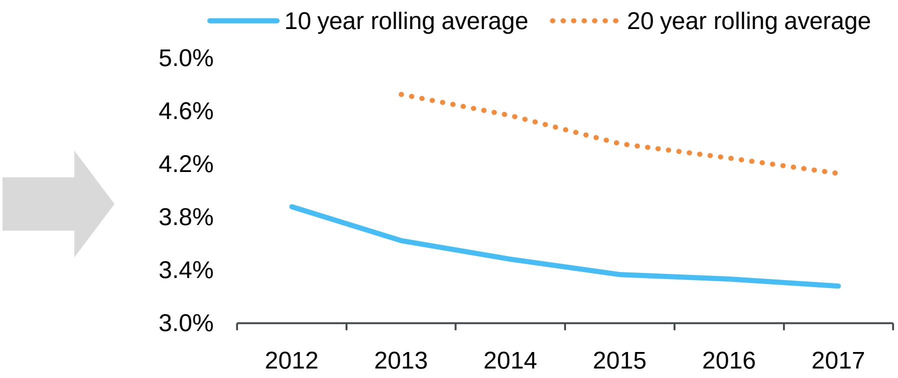
A smooth increase in rates reduces insurers' risk of being unable to meet guarantees

» Investment yields will continue to decline in the next 12-18 months, but at a slower pace and notwithstanding rate increases:
- Portfolios have long-term duration and include old-dated securities; new investments will yield returns below older maturing assets
- The yield of a 6-year duration portfolio is (in part) correlated to the 10-year rolling average of interest rates
- The yield of a 10-year duration portfolio is (in part) correlated to the 20-year rolling average of interest rates

10-year US Treasury rate



Rolling average of 10-year US Treasury rates



Sources: Moody's Investors Service

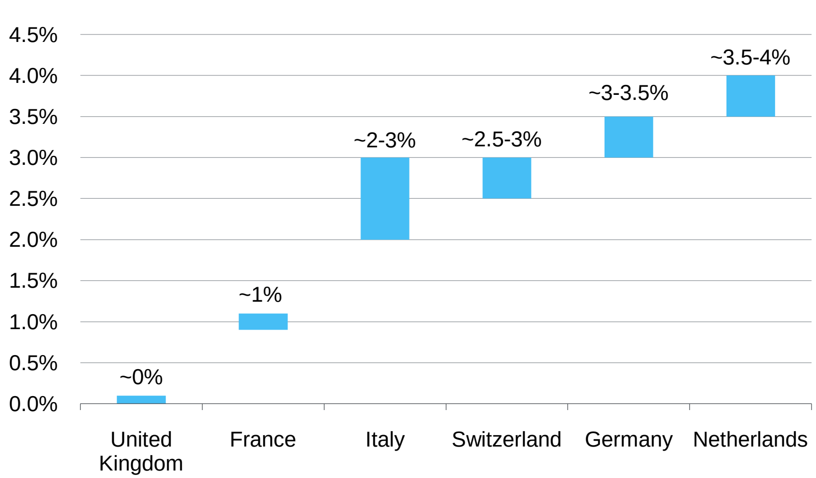
» We expect a diminished risk for a decline of insurers' yields below the level of policyholders' guarantees

1. Interest rates are low but are rising (3/5)

Low interest rates remain a concern in some European countries

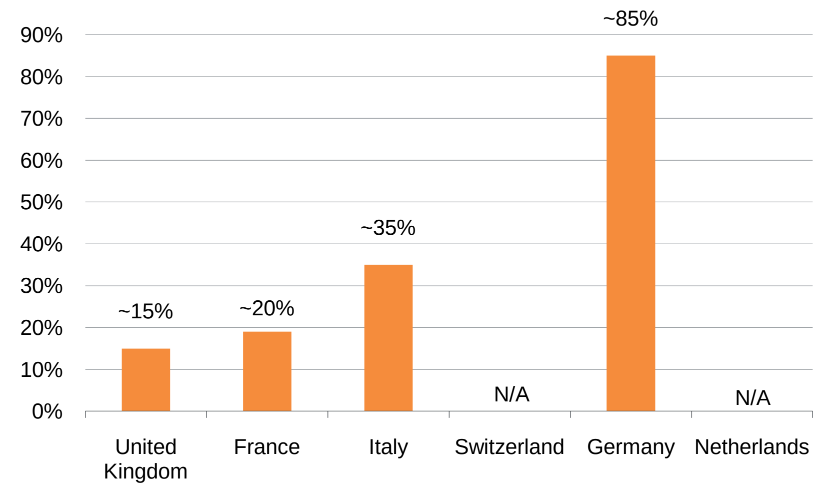
- We expect interest rates in the euro area to increase at a slower pace than in the US
- Germany & the Netherlands are the most exposed to interest rate-risk owing to high policyholders' guarantees and high duration mismatch between assets and liabilities
- Risk for yields falling below guarantees remains high in these countries

Average guaranteed rate on savings products



Sources: Moody's Investors Service, and information disclosed by companies, regulators and other sources including: Aegon, Axa, Generali, Munich Re, Unipol, Zurich, BaFin, FINMA, IMF

Average of mismatch ratio



The mismatch ratio is defined as the discounted value of yearly cash flows shortfall (difference between liabilities cash-flows and assets cash-flows) divided by best-estimate liabilities. The mismatch ratio is correlated to the duration mismatch: the higher the mismatch ratio, the higher the duration mismatch.

Source: European Insurance and Occupational Pensions Authority

1. Interest rates are low but are rising (4/5)

Rising rates to slow down the “hunt for yield” and accompanying risk of asset-quality erosion

» Search for yield has seen different iterations, as follows:

US:	**Europe:**	**Japan:**
Increased allocation to riskier/less liquid assets (e.g., commercial mortgages, bank loans, private placements, hedge funds/private equity)	Investments in illiquid assets expected to continue to increase (e.g., corporate loans, real estate loans, infrastructure investments)	A trend towards increased portfolio exposure to high-yielding foreign securities

» It has had limited impact on asset quality till now and there is reduced risk of deterioration if rates continue to increase

» In Europe, the trend towards changes in the asset mix could end up taking a different shape despite interest-rate trends, owing to structural factors:

– While many European banks are deleveraging amid tightening bank capital and leverage regulations (Basel III), some insurers are gradually increasing their financing activities

– Willingness from policymakers to incentivize insurers to, at least partly, replace bank financing (e.g., by relaxing regulatory constraints on certain asset classes)

» These factors could see persistent allocation to illiquid assets, despite higher interest rates

1. Interest rates are low but are rising (5/5)

A scenario of sharp increase in interest rates would be credit negative for life insurers

» Such a spike could be triggered by a disorderly exit from monetary stimulus measures, particularly in the US

» We initially identified this risk in our Global Macro-Outlook 2013-2015

» An interest-rate spike creates incentives for policyholders to surrender their policies, as the guarantee/credited rates on existing policies would be lower than yields in the markets

» This would force insurers to sell assets, while the market value of fixed income securities would have declined

» This could lead insurers to realize losses on their fixed income securities portfolio

2. The global economy is recovering at a slow pace (1/3)

Navigating towards calmer waters

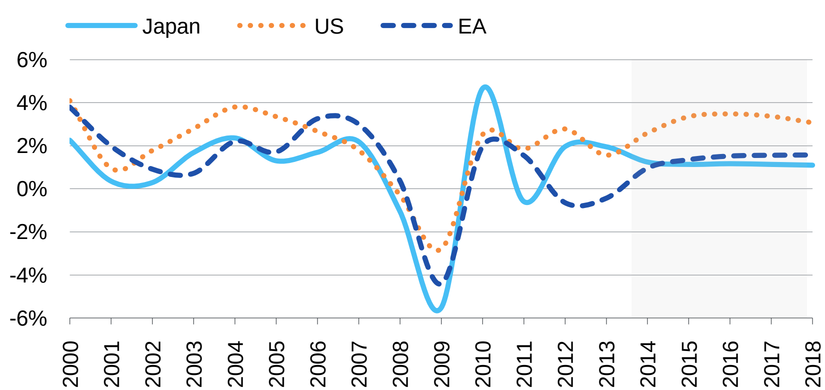
» After a sustained period of turbulence, the global economy now looks set for a period of relative stability*

» Positive growth likely to resume among all G-20 countries

- However, economic growth remains subdued.
- Overall, we expect the advanced G-20 economies to grow by 2.0% in 2014, and around 2.25% in 2015.

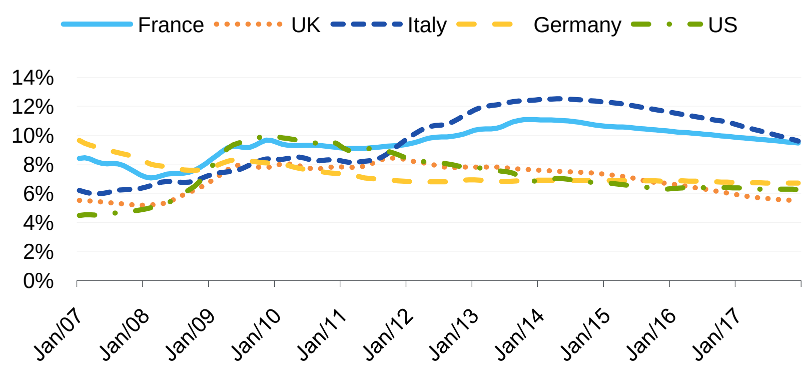
» We expect unemployment to decrease gradually

GDP growth



Sources: Moody's Investors Service, based on IMF data

Unemployment rates



Sources: French National Institute of Statistics and Economic Studies (INSEE); U.K. Office for National Statistics (ONS); Italian National Institute of Statistics (ISTAT); Deutsche Bundesbank; U.S. Bureau of Labor Statistics (BLS); Moody's Analytics Forecast; Moody's Investors Service

*For more detail see Global Macro Outlook 2013-15: Navigating towards calmer waters, 12 Nov 2013

2. The global economy is recovering at a slow pace (2/3)

Economic recovery and reducing unemployment reduces pressures on sales

- Pressures on sales will diminish
  - Sales will remain subdued as savings & purchasing power stay constrained amid weak growth and high unemployment
  - Improvements in both growth and unemployment could reduce constraints and free up expenditure on discretionary items such as life insurance.
- Greater stability in global economy and therefore in financial markets is positive
  - The equity-market recovery has reduced risks in the variable-annuities business
  - Higher equity market levels support results of fee businesses
- Situation remains more challenging in some European countries
  - Weak confidence also leads households to postpone long-term investment decisions, and competition with shorter-term banking products will remain fierce
  - Expected increase in outflows in countries where unemployment rate has increased significantly in 2013, in order to sustain consumption needs
  - Risks of net outflows remain in some countries (e.g, Italy)

2. The global economy is recovering at a slow pace (3/3)

The likelihood of a country exiting the euro area remains at around one in three*

» A flare-up of the euro-area debt crisis remains a particular risk to the global economic outlook
  – Triggers for such an event include the failure to shore up the banking sector and implement institutional reforms

» Further sovereign stress would affect European insurers

Stress event	Impact on European insurers' ratings		
Greek exit	Limited direct credit impact / no direct rating impact		
Deterioration of Spain and Italy	High impact (ratings to follow credit quality of the sovereign) on Spanish and Italian insurers: » Generali » Unipol » Allianz SpA » Mapfre » Caser	Medium impact (possible downgrade if Spain and Italy downgraded in non-investment grade territory) on groups with significant asset and operating exposure to these countries: » Allianz » Axa	Low impact (mostly indirect impacts) on other insurers
Weakening of UK, Germany and France to high/mid –Aa levels	Limited direct credit impact / no direct rating impact		
Weakening of UK, Germany and France to high A levels	High impact (high likelihood of downgrade) on Aa2 insurers: » UK subsidiaries of Prudential plc » German subsidiaries of Allianz	Medium impact on Aa3 insurers (medium likelihood of downgrade): » Allianz » Axa » Legal and General » Munich Re » Zurich Insurance	Low direct impact on insurers rated A or below

*For more detail see Global Macro Outlook 2013-15: Navigating towards calmer waters, 12 Nov 2013

3. Evolving regulations create uncertainties (1/2)

Many global regulatory frameworks to be finalized within a limited time frame

European Solvency II

Directive Omnibus II to be voted in February 2014 by the European Parliament

Level II implementation to be passed in Parliament in August/September 2014

Solvency II to be implemented in 2016

US Solvency Modernization Initiative

Individual states to adopt Own Risk Solvency Assessment (ORSA) Model Act by year-end 2014

State legislatures to debate Principles Based Reserving (PBR) valuation manual throughout 2014

ComFrame

October 2013: IAIS to prepare a workplan to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard

The IAIS is committed to develop the ICS by end-2016. Full implementation is scheduled to begin in 2019 after two years of testing and refinement with supervisors and IAIGs

US non-bank Systemically Important Financial Institutions (SIFIs)

Rules to be developed and timing to be decided

Global Systemically Important Insurers (GSIIs)

July 2014: GSIIs to finalise a SRMP (Systemic Risk Management Plan)

September 2014: IAIS to finalise BCR (Backstop Capital Requirements) to apply to all group activities, including non-insurance subsidiaries

End 2014: GSIIs to finalise RRP (Recovery and Resolution Plan)

End 2015: IAIS to develop HLA (Higher Loss Absorption), capital add-on to be applied to GSIIs and to be implemented in 2019

Note: IAIS = International Association of Insurance Supervisors

3. Evolving regulations create uncertainties (2/2)

Unsettled regulations may create disruption

- Improved regulatory regimes creating incentives to de-risk insurance products, higher capital requirements and increased regulatory oversight are inherently credit positive, however…
- … uncertainties around the final rules limit insurers' business/financial flexibility
- … the accumulation of local and global regulations may increase capital requirements for every local subsidiary, which would limit capital fungibility and resources available at the level of the holding company for international groups
- … this raises the risk of potential divergence of criteria used in the various frameworks, which would also limit insurers' financial flexibility
- For some regulatory initiatives at the incipient stage, further discussions are required. As such, their impact will be subdued during the outlook horizon

4. Insurers are responding to challenges (1/2)

COLOR CODE

- Credit Positive
- Credit Negative

Insurers shift focus on new business

» De-risking and changes in product features

- Insurers reduce guarantees on new business, limit the options they offer to policyholders, and increasingly focus on unit-linked/variable products with no or reduced guarantees/benefits
- These actions are credit-positive and will contribute to improve risk profiles
- However, new business is not material compared to outstanding liabilities and it will take years before it can offset legacy-business risks
- The reduction of guarantees also limits the attractiveness of insurance products

» Expansion in asset management

- As an extreme move to reduce financial guarantees and in order to capture part of the savings and retirement inflows lost by core operations, insurers increasingly diversify in asset management
- Growing competition with asset managers, alongside the trend towards lower risks, leads to the weakening of the insurers' position within the global savings and retirement market

» Focus on insurance risks

- Increased drive to sell protection products with limited financial risks (e.g., accident and health products)
- Insurers seem willing to take on more longevity risk (e.g., pension buyouts)

4. Insurers are responding to challenges (2/2)

Acquisitions and divestments

» Divestments

- Insurers continue to leave countries where interest-rate guarantees are high (e.g., Taiwan, South Korea)
- Insurers sell entire blocks of business (e.g., annuities in the US) to third parties
- Despite accounting losses and the loss of diversification generated by these sales, the transactions have credit-positive implications for sellers

» Expansion in emerging markets

- Insurers will continue to chase acquisitions or bancassurance agreements in high-growth markets (notably Latin America and Asia)
- However, insurers' limited resources and the trend towards deleveraging will limit the size and number of acquisitions
- We view acquisitions into emerging markets as credit negative-to-neutral in the short-term given the execution challenges, the low risk-adjusted returns at the start of these operations and weaker credit profile of many operations in emerging markets

Appendices

Regional outlooks (1/2)

US Life	Japanese Life	UK Life	French Life	China Life
STABLE	STABLE	STABLE	NEGATIVE	STABLE
Key drivers: » Rising interest rates should continue to relieve pressure on life insurers' profits » Economic stability supports greater insurance purchases » Rising equity markets will continue to improve the performance of variable annuity portfolios and other AUM-fee driven businesses	Key drivers: » «Abenomics» policy expected to end deflation, achieve stronger GDP growth and normalise Japan's interest rate environment	Key drivers: » Expected earnings stability supported by increasing cash generation » Resilient capitalisation sustained by conservative capital management » Strong performance of captive asset managers	Key drivers: » Stabilisation of net cash flows » Government's current policy and macro-economic environment are not conducive to insurers being able to fully capture existing growth opportunities » Unfavourable fiscal policy	Key drivers: » We expect insurers to preserve their profitability and capitalization levels in the face of subdued premium growth in the next 12-18 months » Growth in the domestic economy and a stable monetary policy over next 12-18 months will continue to support the financial performance of life insurers

Regional outlooks (2/2)

German Life	Italian Life	South Korean Life	Taiwanese Life	Canadian Life
NEGATIVE	NEGATIVE	STABLE	NEGATIVE	STABLE
Key drivers: » Low interest rates will continue to weigh on life insurers' profitability and capitalisation	Key drivers: » The low savings rate and high unemployment will continue to limit demand for life insurance » Continuing volatility in life net flows expected over the outlook period » Italian sovereign credit quality	Key drivers: » Stable premium growth expected » Tightening regulatory regime to enhance capitalization	Key drivers: » Subdued new business growth » Continued negative spreads » Increasing accumulation of asset risks to offset the impact from low domestic interest rates » Intensifying competition	Key drivers: » Modestly improving economic fundamentals » Management actions to hedge market exposures

Issuers of interest – Global Systemically Important Insurers (G – SIIs) (1/2)

Issuer	Senior Debt Rating	What to watch for
AIG	Baa1 stable	» Further improvement in risk-adjusted profitability at AIG PC » Divestiture of ILFC and continued runoff of the DIB and GCM » Further improvement in parent company's fixed-charge coverage » Maintenance of robust liquidity within operating units and at the parent
Allianz	Aa3 negative	» Evolution of credit quality of European sovereigns, particularly Italy, and of European banks » Operating profitability development in key markets, especially Germany, Italy and the US
Assicurazioni Generali	Baa2 negative	» Evolution of the Italian sovereign credit profile » Changes in capitalisation
Aviva	(P)A3 stable	» Potential further divestments of the remaining non-core operations as per the Group's July 2012 strategic plans » Reduction in external and internal leverage, in line with Group plans to repay at least £500m of external debt and £600m of internal debt over the next 2-3 years » Increase in capital remittance ratios from operating entities to Aviva Plc » Lower operating expenses and integration & restructuring costs, in line with management targets
AXA	A2 negative	» Underlying profitability development in key mature markets and in emerging countries » Evolution of credit quality of European sovereigns, particularly Italy and Spain, and of European banks

Issuers of interest – Global Systemically Important Insurers (G – SIIs) (2/2)

Issuer	Senior Debt Rating	What to watch for
MetLife	A3 negative	» Execution of the company's strategic plan to grow in emerging markets, build global employee benefits businesses and shift product mix toward protection products and away from capital-intensive products » Potential improvement in profitability, cash flow coverage and earnings coverage ratios
Ping An	Non rated	» How the group manages multiple demands for capital from its diverse business including insurance, banking, securities and asset management, which are all growing rapidly » Capital market developments and their impact on Ping An Group’s earnings and capitalization, given the significant exposure to the equity market in the life insurance business » Asset quality and capitalization at Ping An Bank
Prudential plc (UK)	A2 stable	» Growth concentrated in variable annuities that could compromise the balance of risk at Jackson and at the group level
Prudential Financial (US)	Baa1 stable	» The level of variable annuity sales and the guarantees associated with them » Prudential's total leverage

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