

## SECTOR IN-DEPTH

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## European Insurance

# Insurers Ready to Deploy Excess Capital in 2017, CFO Survey Shows

European insurers are now considering channeling surplus capital into mergers and acquisitions (M&A) or share buybacks, in stark contrast to last year, according to Moody's 2017 annual survey of European insurance sector Chief Financial Officers (CFOs). The industry also remains worried over low interest rates, which rank as its biggest concern for the second year running. The survey is based on responses from 18 insurers, including many of the largest European multinationals.

- » **Deployment of excess capital back on the agenda.** With insurers reporting solid levels of capital more than a year after the introduction of Solvency II, CFOs' attention is now turning towards the deployment of surplus capital. Over 40% of respondents are considering putting excess capital to use, up from just over 10% in 2016. M&A and share buybacks are the most frequently-cited options for insurers seeking to deploy excess capital.
- » **Prolonged low rates remain CFOs' biggest concern.** One third of survey respondents named low interest rates as the top challenge for the insurance industry in 2017, down only slightly from last year. Low rates remain the sector's single biggest worry, as they force insurers to reinvest maturing assets at lower than historical rates of return (Please see our report: [Global Insurance: Despite Rise, Still-Low Interest Rates a Threat to Profitability](#)).
- » **Moderate increase in appetite for higher-yielding illiquid assets.** There has been some increase in insurers' appetite for illiquid investment assets, with around 30% of respondents anticipating increased exposure to real estate, private placements, infrastructure and mortgages/loans. Insurers have shifted gradually towards higher-yielding assets in response to low interest rates, a trend we expect to continue.
- » **Technology investment to increase, with growing focus on AI.** Insurers' technology investment is currently focused on improving customers' access to their services, making greater use of "Big Data", and improving back office functionality. Around 90% of respondents said they had already adopted these technologies. We think "Internet of Things" and Artificial Intelligence (AI) will likely be the CFOs next investment focus.
- » **Debt outstanding to remain broadly stable.** Insurance CFOs do not expect to issue large volumes of debt in the next 24 months, with 44% of survey respondents saying they expect to borrow only enough to cover their refinancing needs.

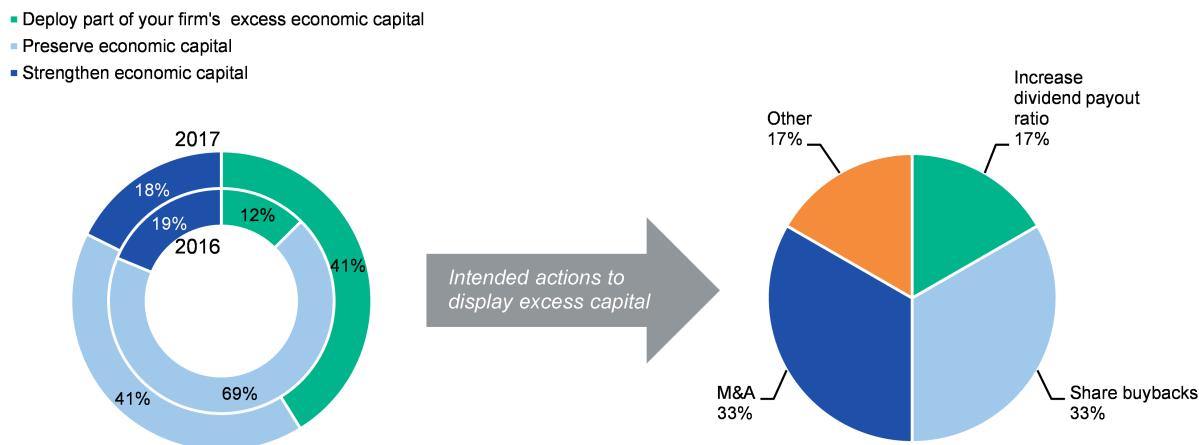
## Deployment of excess capital back on the agenda

With insurers reporting solid levels of capital one year after the Solvency II regime took effect (please see our report [Insurers - Europe: New Solvency II disclosure to provide insight, but unlikely to change our credit view](#)), CFOs' attention is now moving towards the deployment of excess capital. Forty-one percent of survey respondents said they were considering putting surplus capital to use, up from just over 10% in 2016 (see Exhibit 1). Of these, 33% said they were willing to engage in M&A, while another 33% said that they may buy back shares.

Most of our European insurance universe reported Solvency II capital ratios comfortably above the 100% regulatory intervention level in 2016. This explains why only 18% of surveyed CFOs said strengthening their firms' economic capital was a key priority in 2017.

Exhibit 1

### Insurers are increasingly willing to deploy excess capital (2017 responses compared with 2016)



Source: Moody's CFO survey

### Increased M&A appetite in both domestic and emerging markets

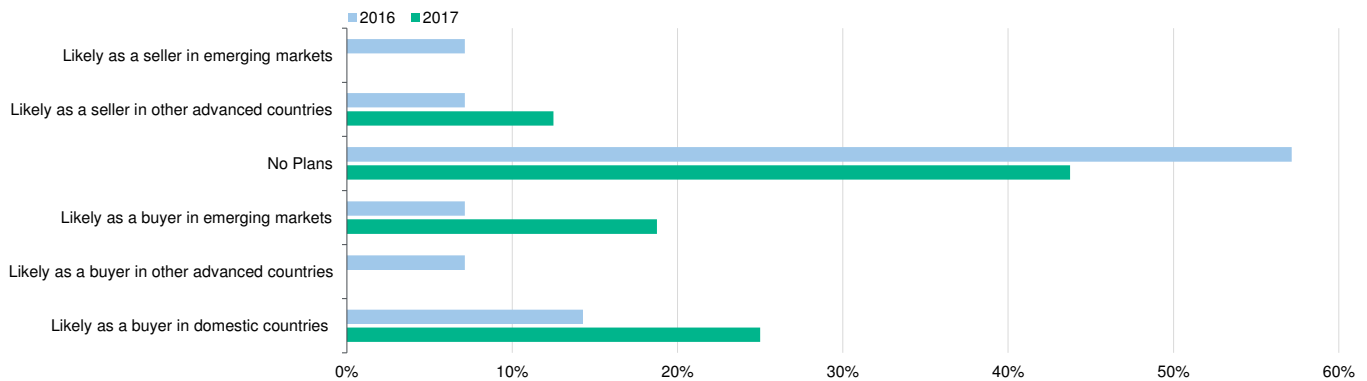
Reduced pressure on capital appears to have fuelled increased interest in M&A. Of the CFOs surveyed, 25% said they were likely to be buyers in their home markets, while 19% said they were likely to acquire in emerging markets (see Exhibit 2). Forty-four percent of respondents said they had no M&A plans, down from 57% in 2016.

Examples of European insurance sector M&A in 2017 so far include Zurich Insurance Company's (rated Aa3 IFSR, stable) acquisition of Cover-More Group Limited for USD551 million (net of dividends) in April<sup>1</sup>, and NN Group's (Baa2 long-term issuer rating, stable) completion of its offer to acquire Dutch insurer Delta Lloyd NV for EUR2.5 billion<sup>2</sup>. Separately, Standard Life Plc's (Baa1, long-term issuer rating, stable) has announced a planned merger with Aberdeen Asset Management Plc<sup>3</sup>, and Aegon N.V.'s (A3 long-term issuer rating, negative) has acquired Cofunds for £140 million<sup>4</sup>.

Some large insurers have also announced new share buyback programmes or extended existing ones. Aviva Plc (A1 IFSR, stable) announced in May that it will repurchase up to £300 million of its shares<sup>5</sup>. In February, Allianz SE (rated Aa3 IFSR, stable) launched a programme to buy back up to EUR3 billion of its stock, subject to the company maintaining a sustainable Solvency II ratio above 160%<sup>6</sup>.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

Exhibit 2

**Insurers' M&A appetite has increased in 2017 vs 2016**

Source: Moody's CFO survey

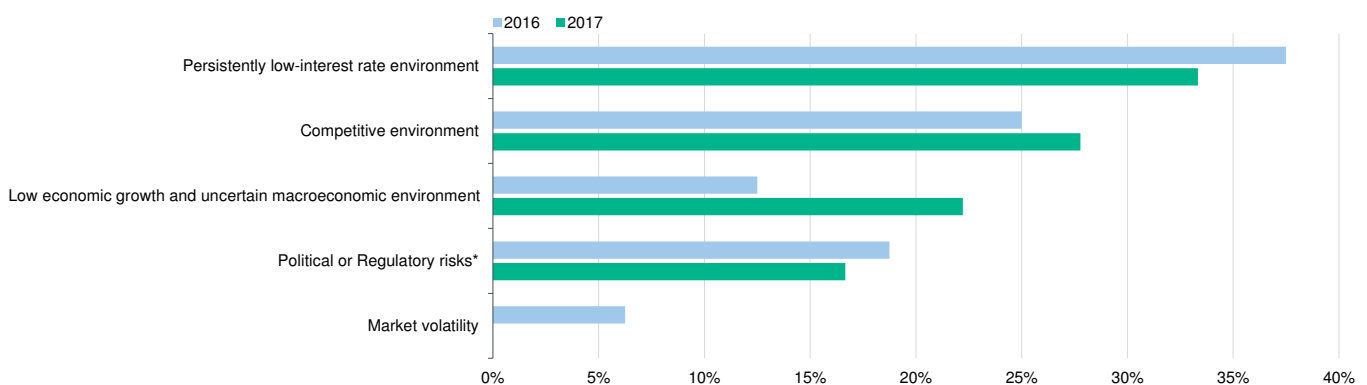
**Prolonged low rates remains CFOs' biggest concern**

Low interest rates rank as European insurance CFOs' main concern for the second consecutive year in 2017. This is in line with our own view of the challenges facing the sector.

One-third of respondents cited persistently low interest rates as their main worry, down only slightly from 38% in 2016 (see Exhibit 3). Intensely competitive conditions were ranked second, cited by 28% of respondents. The CFOs also seem worried over weak economic growth in Europe, with 22% citing it as their key concern, up from 13% in 2016. However, the proportion of insurers' expressing concerns over political and regulatory risks in Europe fell slightly to 17%.

None of the respondents expressed concerns regarding a potential sudden increase in interest rates. An abrupt rise in rates is also not our central scenario, but we believe it would have the greatest adverse impact on life insurers in France and Italy, as it could trigger a sudden increase in policy surrenders due to increased competition from the banking sector in those countries. Insurers would also be forced to realise investment losses. Our central scenario is that there will be a gradual increase in interest rates over the next 12-18 months.

Exhibit 3

**Low interest rates remain insurers' key concern**

\*includes concerns around Brexit for 2016 results

Source: Moody's CFO survey

### Insurers taking steps to offset low interest rates

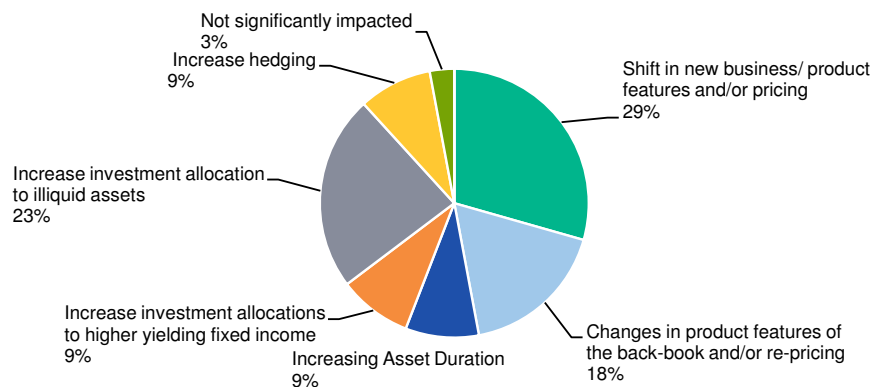
Exhibit 4 shows the full range of measures survey respondents have taken to counteract low interest rates. Of the CFOs surveyed, 29% have changed the product features or pricing of new business, while 18% have changed the product features of their back-book.

Measures of this kind taken by life insurers in Europe typically include reductions in the guaranteed returns attached to traditional life insurance products, and increased sales of unit-linked products. We view these steps positively as they will reduce capital consumption. However, in our view, any changes to insurers' liability profiles have been marginal, and their exposure to guaranteed products is virtually unchanged, particularly as compared to the total level of liabilities (see Exhibit 5).

A combined 32% of respondents have opted to increase their investment in illiquid assets and higher yielding fixed income.

Exhibit 4

#### Insurers are taking steps to protect themselves from low interest rates

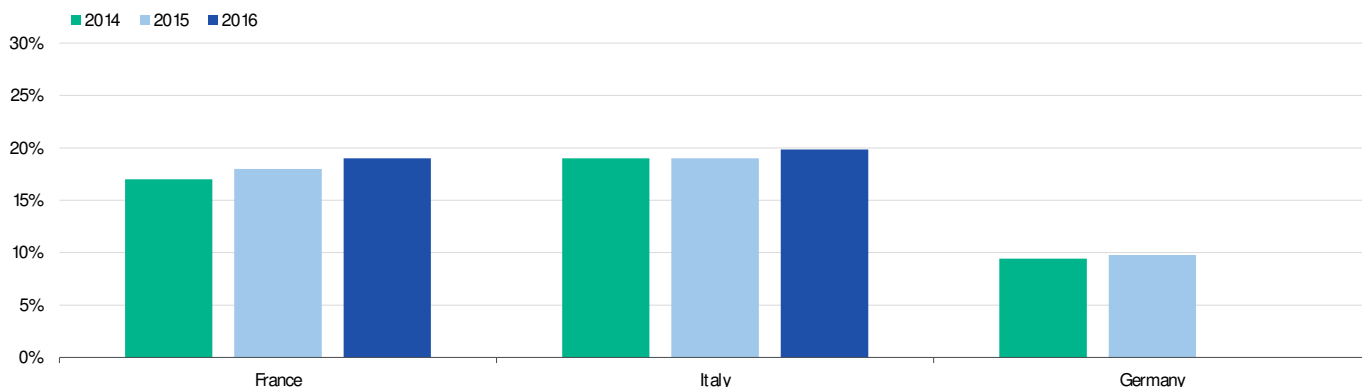


Source: Moody's CFO survey

Exhibit 5

#### Life insurers are changing the business mix, but the change has been marginal

##### Unit Linked Business % Reserves

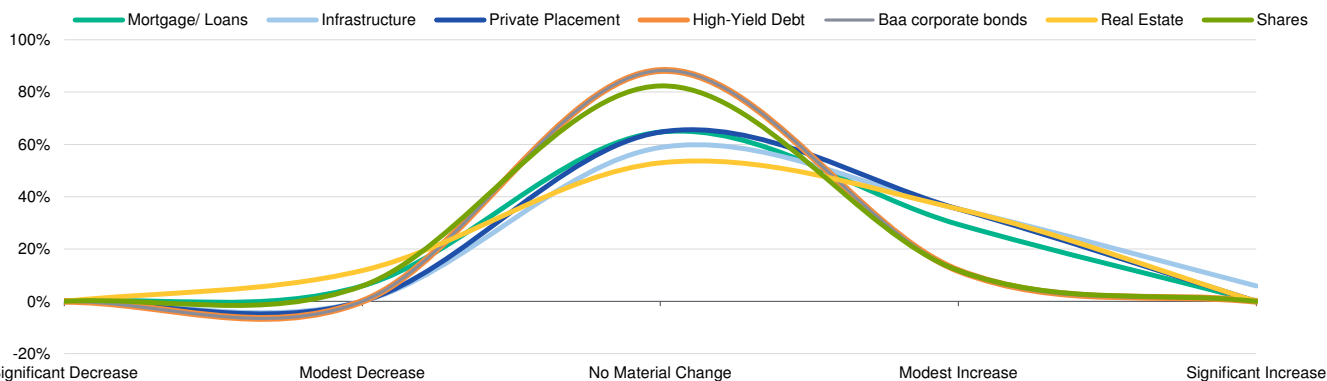


Sources: Fédération Française de l'Assurance, Autorité de Contrôle Prudentiel et de Résolution, Associazione Nazionale fra le Imprese Assicuratrici, Istituto per la Vigilanza sulle Assicurazioni, Gesamtverband der Deutschen Versicherungswirtschaft e. V., Bundesanstalt für Finanzdienstleistungsaufsicht

### Moderate increase in appetite for higher-yielding illiquid assets

There has been some increase in insurers' appetite for illiquid assets, with around 30% of respondents anticipating modestly increased exposure to real estate, private placements, infrastructure and mortgages/loans. Insurers have shifted gradually towards higher-yielding assets in response to low interest rates, a trend we expect to continue.

Exhibit 6  
Insurers expect modest increases in some invested asset classes



Source: Moody's CFO survey

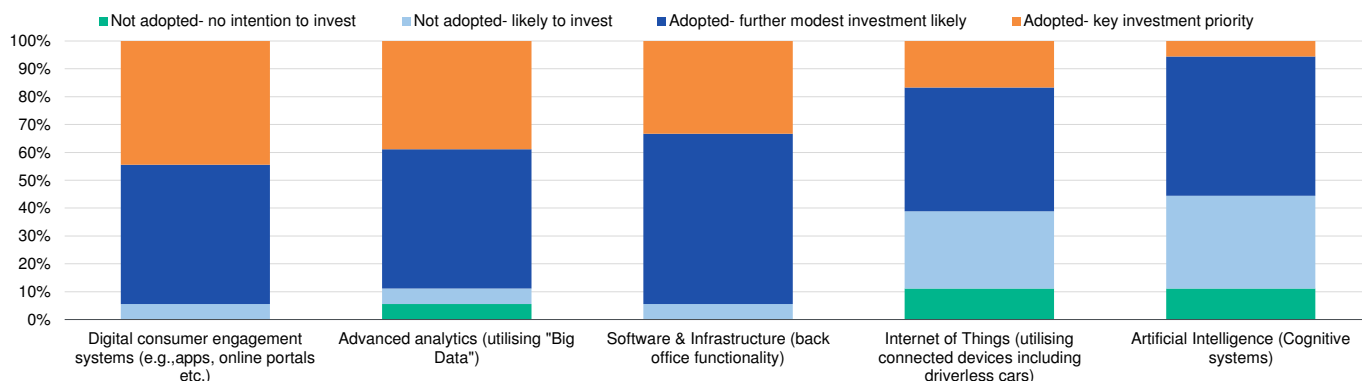
### Technology investment to increase, with growing focus on AI

Technology is among the key strategic priorities for insurers as they seek to improve efficiency and profitability in the face of slow global economic growth, low interest rates and an increased regulatory burden (Please see [Insurance Global: As Technology Transforms Landscape, Innovative Insurers Have Competitive Edge](#)).

Around 90% of survey respondents said they had already adopted to technologies that improve customers' access to their services (via digital consumer engagements), make greater use of "Big Data", and improve back office functionality via software and infrastructure (see Exhibit 7). We think "Internet of Things" and Artificial Intelligence will likely be the CFOs next investment focus (see Exhibit 7).

More than 50% of respondents believe these technological advances will be a source of opportunities for the insurance sector in the long run, while less than 30% anticipate disruption.

Exhibit 7  
Many insurers have already adopted advancing technologies



Source: Moody's CFO survey

Fifty-six percent of respondents said the rigidity of their legacy systems and the complexity of the insurance business were the greatest impediments to adopting new technology. Many of the largest insurance groups have complex legacy IT infrastructures that are costly, inefficient to run, and difficult to adapt to new distribution channels, data sources or product lines.

In recent years, many groups have therefore embarked on multiyear projects to upgrade their systems. These upgrades have the potential, when complete, to reduce operating and IT expenses, supporting profit margins at a time when low interest rates and muted economic growth continue to weigh on revenues and investment income.

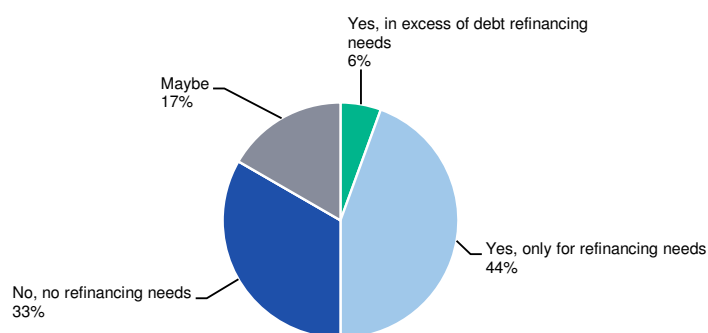
### Debt outstanding to remain broadly stable

European insurers do not expect to issue large volumes of debt in the next 24 months. Around 44% (see Exhibit 8) of survey respondents said they expected to issue only sufficient debt to cover refinancing needs, up from 33% in 2016.

A further 33% of respondents do not expect to issue debt at all, either because none of their existing debt is due to mature, or because they are focused on deleveraging. Just 6% of respondents said they were open to issuing debt in excess of refinancing needs over the next 24 months, given generally low funding costs.

Exhibit 8

#### CFOs plan modest debt issuance



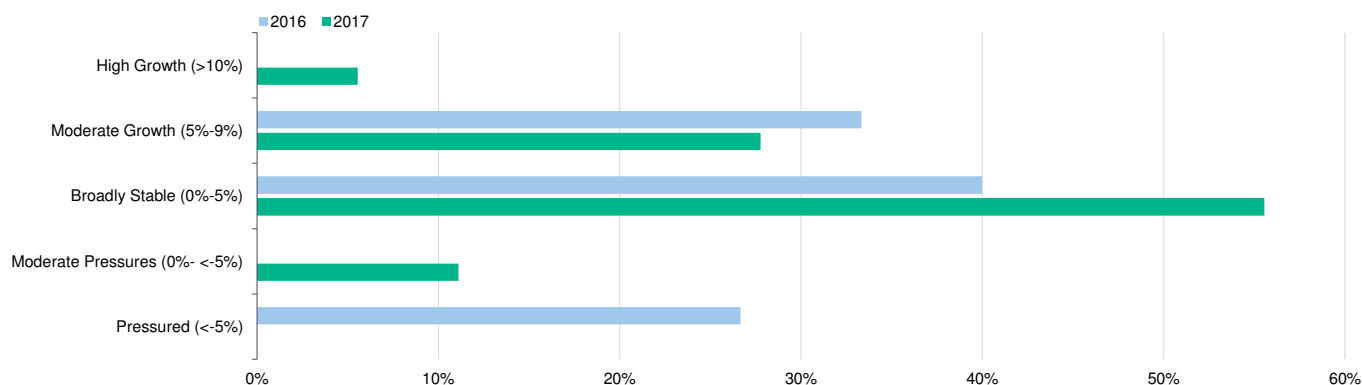
Source: Moody's CFO survey

### Profitability outlook stable

Our survey shows that CFOs' profitability outlook for 2017 is stable. Fifty-six percent of respondents said they expected broadly stable operating profitability in 2017 (see Exhibit 9), up from 40% last year.

Exhibit 9

#### Most insurers expect broadly stable operating profit in 2017

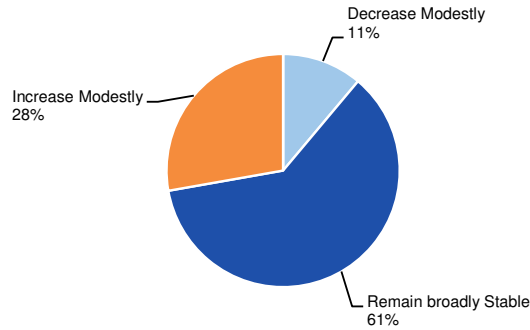


Source: Moody's CFO survey

Sixty-one percent of survey respondents said they foresaw no significant increase in demand for insurance in 2017/18 (see Exhibit 10), despite a modest economic recovery in Europe. Demand for life insurance is generally more discretionary and confidence-sensitive than for non-life insurance. The pricing picture for property & casualty insurance remains broadly flat across the continent, though there are significant variations by country.

Exhibit 10

**Most insurers expect demand for insurance and long-term savings products to remain stable**



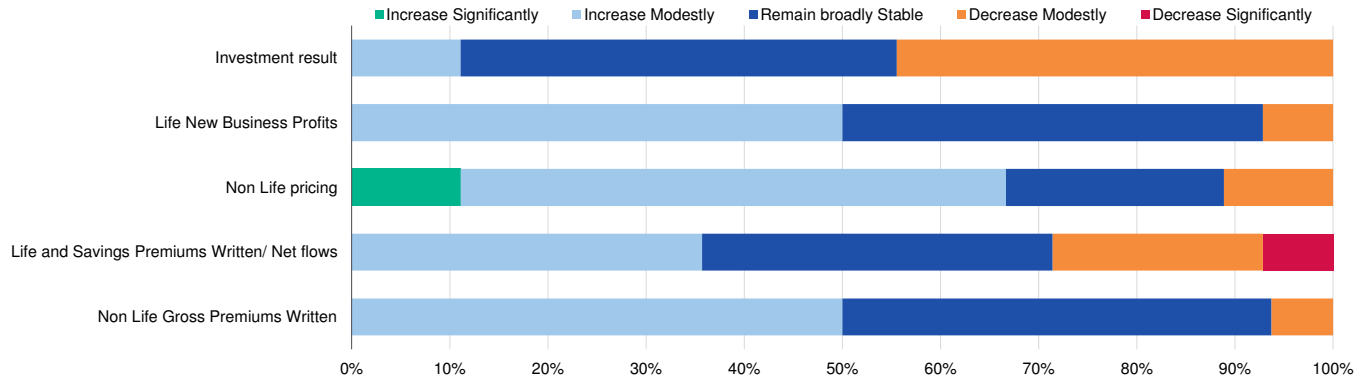
Source: Moody's CFO survey

**Investment income declining for almost half of the respondents**

Most CFOs expect profitability, pricing and premiums flows to remain broadly stable or increase modestly, with investment income declining for almost half of the respondents (see Exhibit 11). This is in line with our expectations, given the current economic backdrop and barriers to re-pricing existing products in some countries. Most insurers also expect to cut operating expenses, with 61% of respondents planning moderate reductions.

Exhibit 11

**Most insurers expect their investment result to decrease moderately or stay stable in 2017**



Source: Moody's CFO survey

## Moody's Related Research

- » [Global Insurance: Despite Rise, Still-Low Interest Rates a Threat to Profitability](#), April 2017
- » [Insurers - Europe: New Solvency II disclosure to provide insight, but unlikely to change our credit view](#), April 2017
- » [Insurance Global: As Technology Transforms Landscape, Innovative Insurers Have Competitive Edge](#), June 2016
- » [Insurance Europe: A Lower UFR Will Drive Lower, More Meaningful Reported Solvency Ratios](#), April 2017
- » [Life Insurance Global: 2017 Outlook -Low Interest Rates, Risk of High Volatility and Legislative Changes Turn Outlook To Negative](#), December 2016
- » [P&C Insurance -Global: 2017 Outlook -Continued Premium Growth Supported by Economy, but Pricing and Investment Headwinds Remain; Stable Sector Outlook](#), December 2016

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.



## Endnotes

- 1 [Zurich completes acquisition of Cover-More to become top three global travel insurance provider](#)
- 2 Please see our report [NN Group N.V. No rating impact on NN Group following Delta Lloyd recommended transaction](#)
- 3 [Moody's changes Standard Life's outlook to stable from negative following the announced merger with Aberdeen](#)
- 4 Please see our report [Aegon's Weak US Results Offset Its Credit-Positive Acquisition of Cofunds](#)
- 5 [Aviva to commence share buy-back](#)
- 6 [Allianz SE launches share buy-back with a volume of up to 3 billion euros](#)

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