MOODY'S INVESTORS SERVICE

OUTLOOK
13 September 2018

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Life insurance - UK

Expectation of continued resilient performance drives stable outlook

We maintain a stable outlook on the UK life insurance industry, as we expect its resilient performance to continue. The sector, which is comfortably capitalized, is well positioned to benefit from growth in the pensions, retirement and bulk annuity markets. However, persistent regulatory headwinds are likely to compound margin pressure, and Brexit has introduced a high level of uncertainty over the UK's economic outlook.

Resilient performance to continue. In 2017 and H1 2018, most UK life insurers increased their operating profit. We expect performance to remain resilient, thanks to continued growth in pensions and retirement products. This reflects rule changes giving savers more freedom to manage their retirement savings, as well as structural shifts such as pensions auto-enrolment, and the move from defined benefits to defined contribution schemes.

Bulk annuity demand is strong. A number of UK life insurers remain focused on growing risk products such as bulk annuities, which are heavily in demand. However, players in this market rely on reinsurers to off-load longevity risk, and the ability to source higher-yielding illiquid assets is critical to profitability.

Solvency II capitalisation is comfortable. Most UK life insurers' Solvency II ratios improved during 2017, with some reporting ratios close to or above 200%. However, the UK regulator has increased its scrutiny of the matching adjustment, a mechanism which shields annuity writers from the impact of short-term market movements. The outcome of its review of equity release mortgages may negatively affect the Solvency II ratios of some insurers most exposed to this product.

Regulatory headwinds are likely to exacerbate margin pressure. The Financial Conduct Authority's (FCA) drive to ensure that financial services firms treat their customers fairly has put the UK life sector under increased regulatory scrutiny. We expect this to continue for some years, with a potentially negative impact on margins. In addition to its ongoing review of non-advised annuity sales practices, the FCA is looking into the individual pension and investment platform markets, which could lead to increased competition in these areas.

Brexit impact expected to be moderate, but uncertainty has increased. We continue to foresee a moderate impact on life insurers from Brexit, and see operational risks over the next 12 to 18 months as manageable. We expect the UK economy to expand by 1.3% in 2018, and anticipate that the sector will also benefit from a gradual increase in government bond yields. However, the ongoing Brexit negotiations introduce a high level of uncertainty over the UK's economic outlook.

Definition of an Industry Outlook

The Industry Outlook (positive, stable or negative) indicates our forward-looking assessment of fundamental credit conditions that will affect the creditworthiness of the life insurance industry over the next 12-18 months. As such, the outlook provides our view of how the operating environment for the life insurance industry, including macroeconomic, competitive and regulatory trends, will affect, among other things, asset quality, capital, funding, liquidity and profitability. Since outlooks represent our forward-looking view on credit conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the direction of credit fundamentals overall within the industry broadly.

Exhibit 1
Moody's UK life insurance ratings (as of 13 September 2018)

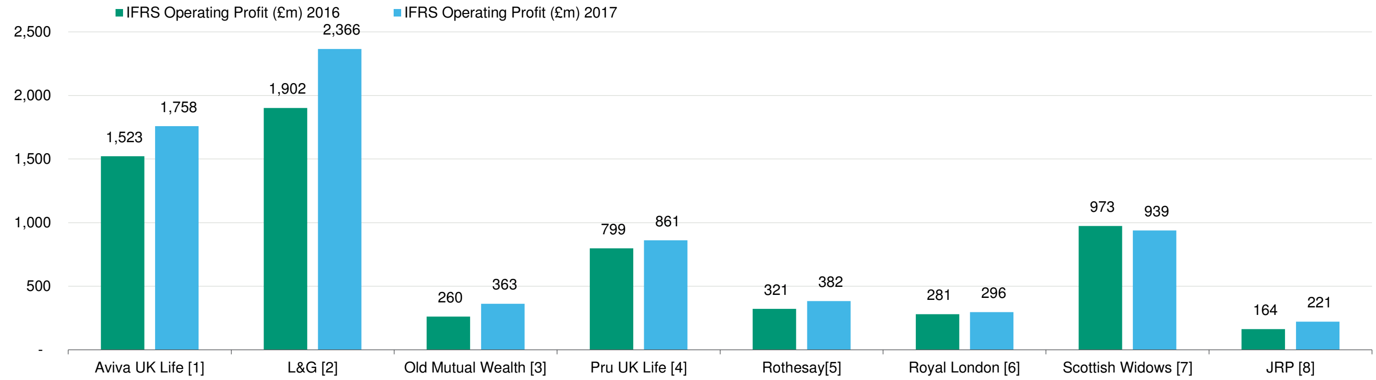
Insurance Groups	Insurance Financial Strength Rating of Lead UK Life Company	Senior Debt Rating	Subordinated Debt Rating	Outlook on Ratings
Aviva Plc	Aa3	A2	A3 (hyb)	STA
Legal & General Group Plc	Aa3	(P)A2	A3 (hyb)	STA
Prudential Plc	Aa3	A2	A3 (hyb)	STA
Rothesay Holdco UK Ltd.	A3	Baa2[1]	--	STA
Royal London Mutual Insurance Society Ltd.	A2	--	BACKED Baa1 (hyb)	STA
Scottish Widows Plc	A2	--	Baa1 (hyb)	STA
Standard Life Assurance Ltd.	A1	--	--	NEG

[1] Senior Debt Rating refers to Rothesay Holdco UK Ltd's issuer rating
Source: Moody's Investors Service

Resilient performance to continue

In 2017, most UK life insurers increased their IFRS operating profit by an average of 18% (see Exhibit 2) despite increased competitive pressure on margins and fees. A number of insurers also increased their value of new business (VNB): Aviva's 2017 UK VNB rose 23%, while Prudential's UK life business and Royal London achieved increases of 28% and 30% respectively. Performance has also remained good during H1 18 with Aviva's and Prudential UK life businesses, Just Group, L&G and Scottish Widows all reporting an increase in operating profit.

Exhibit 2
Most UK life insurers reported stronger operating profit in 2017



[1] Aviva UK Life: IFRS operating profit represents the as reported adjusted operating profit before tax
[2] L&G: Group IFRS operating profit on a pre-tax basis
[3] Old Mutual Wealth Ltd was renamed to Quilter Plc in June 2018; IFRS operating profit represents the as reported adjusted operating profit before tax
[4] Pru UK Life: IFRS operating profit relates to Prudential Group's UK long-term business and is reported on a pre-tax basis
[5] Rothesay: IFRS operating profit on a pre-tax basis
[6] Royal London: IFRS operating profit is reported before tax and before exceptional items
[7] Scottish Widows is consolidated in Lloyds' accounts on an IFRS basis that resembles an embedded value framework. Consequently, we consider underlying profit including general insurance and wealth management as operating profit
[8] JRP: 2016 Pro forma adjusted operating profit for both Just Retirement and Partnership
Source: Company reports, Moody's Investors Service

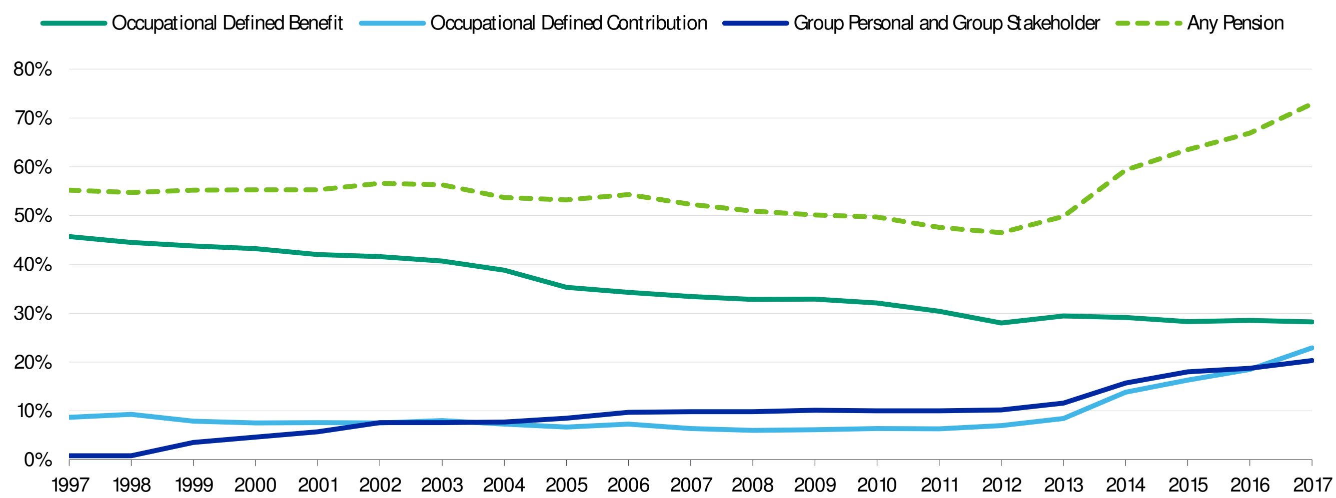
Insurers specialising in savings or risk products, as those involved in both markets, achieved profitability gains. We expect the UK life industry's performance to remain resilient, thanks to continued growth in the pensions and retirement products market. UK pension reforms that took effect in 2015 have given retirees greater freedom to invest their pension savings, and have led to a meaningful increase in sales of individual pensions and income drawdown products.

Other long-term structural shifts such as the automatic enrolment of employees into corporate pension schemes unless they ask to be omitted (auto-enrolment), the steady substitution of more costly defined benefit (DB) schemes for defined contribution (DC) pension schemes, and the UK's ageing population should fuel continued growth. This gives UK life insurers, some of which are expanding their asset management divisions, significant asset gathering and fee revenue generation capability.

Insurers are strongly positioned in the corporate pensions market

Insurers such as Aegon, Aviva, L&G and Scottish Widows dominate the UK corporate pensions market and are well-positioned to take advantage of further growth opportunities generated by auto-enrolment. In 2017, 73% of employees saved into a workplace pension, the highest proportion since records began in 1997 (Exhibit 3), likely driven by the introduction of auto-enrolment in 2012. A scheduled increase in the minimum auto-enrolment contribution rate in 2018 to 5% of eligible earnings from 2% will, over time, boost insurers' assets under administration (AUA), helping to compensate for the low margins on corporate pension products. The Department for Work and Pensions estimates that by 2019/2020, auto enrolment will have increased annual workplace pension contributions by £20 billion relative to 2016, when they stood at £87 billion.

Exhibit 3
The proportion of UK employees with workplace pensions rose in 1997-2017



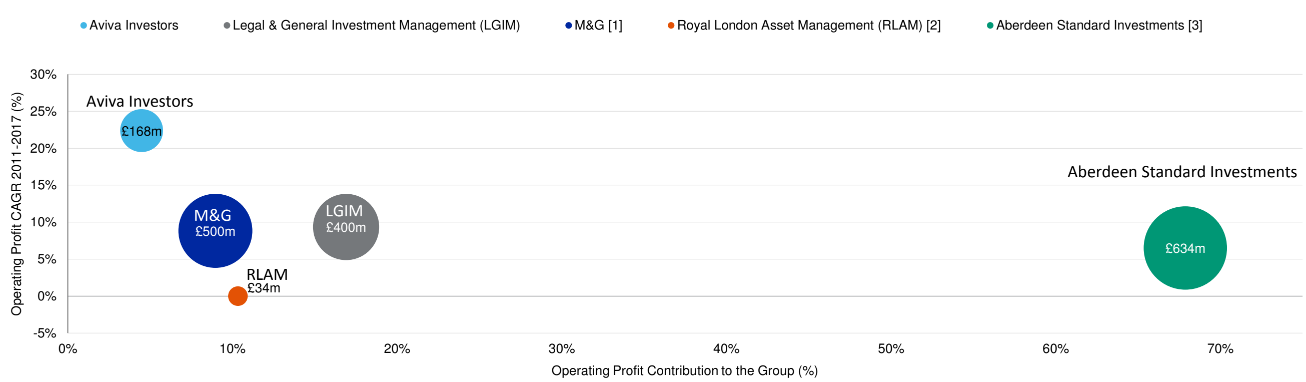
Source: UK Office of National Statistics, Moody's Investors Service

Insurers are building up asset management businesses

We expect insurers such as Aviva, L&G, Prudential and Royal London to continue building up their fund management businesses, which have diversified their revenues at a lower capital cost, a credit positive. A number of insurer-owned asset managers have reported meaningful growth in operating profit over the last few years, although some, such as Aviva Investors, started from a low base.

Asset management is a significant contributor to group operating profits at Legal & General, and accounted for the majority of YE 2017 profits at Standard Life Aberdeen (Exhibit 4). Standard Life Aberdeen is now fully focused on fund management, having completed the sale of its life insurance arm to Phoenix Group in August 2018. Asset management will also be a significant source of earnings for M&G Prudential, once its proposed demerger from Prudential plc is complete.

Exhibit 4
Insurer-owned asset managers' profit continues to grow



[1] M&G is owned by Prudential
[2] Operating profit for Royal London is on a European Embedded Value (EEV) basis as of YE2017. In order to capture the operating profit of RLAM, we use operating profit from "Wealth" segment as it mainly comprises the fund management operation of the Group.
[3] 2011 Pro-forma for combined entity. Information for Aberdeen based on IFRS financial statements as of Fiscal YE September 30
Source: Company reports, Moody's Investors Service

However, while reforms have created growth opportunities in the pensions market, insurer-owned asset managers risk losing maturing pension assets due to stiff competition from pure asset managers. Moreover, insurers with a dependence on fund management revenues are exposed to intense competitive pressure and rising regulatory and technology costs across the asset management industry, and may suffer greater earnings volatility. Recent significant net outflows at Standard Life Aberdeen, which have weighed on its margins, illustrates the potential difficulties in retaining asset management clients. Traditional insurance customers, in contrast, are less likely to switch to competitors.

Insurers are also among the main providers of income drawdown products, which generate a variable income for retirees by investing their pension savings. These products have become more popular than annuities as a result of low interest rates and pension reforms. According to the FCA, in addition to the 55% of pension pots accessed since October 2015 which have been taken as full cash withdrawals, 30% have gone into drawdown, while just 12% have been taken as an annuity. Income drawdown margins are lower than those on individual annuities, making them a scale play for insurers. However, they carry lower capital charges than annuities, supporting their return on capital.

Bulk annuity demand is strong

A number of UK life insurers remain focused on growing risk products such as bulk annuities, a market that grew by 17% to £12 billion of business volume in 2017. Bulk annuity demand is increasing in the UK, which currently has about £2 trillion of defined benefit liabilities. Corporates in particular are keen to de-risk their defined benefit liabilities. Rising interest rates, which narrow the funding gap in pension schemes and therefore make bulk annuity deals more affordable, should also stimulate demand.

The bulk annuity market has relatively high barriers to entry, and bulk annuities typically command much higher margins than savings products. Nevertheless, the market has become more competitive recently, with Canada Life, Phoenix and Scottish Widows all providing additional capacity. Furthermore, US-based Prudential Financial has been active in recent years in providing longevity risk protection to UK pension funds. A supply/demand imbalance put pressure on pricing in 2017, although we expect this to be corrected in the future by rising demand.

Reliance on reinsurance is a potential long-term risk

Bulk annuities are very capital consumptive under Solvency II because they expose insurers to longevity risk. Bulk annuity writers have therefore typically ceded most of their longevity exposure, with most of the deals transferring at least 80% of the risk, to reinsurers via quota share treaties and/or unfunded longevity swaps. This reliance on reinsurance is a potential long-term risk, although in the short to medium term we believe reinsurers have continued appetite for longevity exposure, which acts as a natural hedge against their dominant mortality risks. Moreover, mortality trends have recently become favourable for UK life insurers, with longevity exposure leading to reserve releases which have meaningfully boosted profitability.

Higher-yielding illiquid assets are critical to profitability

Writing bulk annuities also requires insurers to source higher-yielding illiquid assets to match illiquid annuity liabilities, and to enable more competitive pricing. This can be challenging as demand for such assets can exceed supply. The assets can also be complex, not externally rated, and obtaining matching adjustment approval is key. Furthermore, these illiquid assets are often not sourced until after the execution of bulk annuity deals, as exemplified by Aviva and Rothesay in their H1 18 reporting. This leads to an initial negative impact on profitability and places the onus on insurers to source the assets in order to meet the investment return assumptions factored into the transaction.

Individual annuity market starting to grow again

Individual annuities continue to offer some opportunities, despite regulatory changes in 2015 that essentially removed the requirement for retirees to buy annuity products. After stabilizing in 2016, sales have grown steadily and could accelerate in future, especially if interest rates rise and financial market fluctuations make returns from alternative income drawdown products more volatile. Open market individual annuity sales could especially benefit from rules introduced by the FCA in March 2018 requiring pension providers to inform customers with maturing pension assets how much they could gain from shopping around with other annuity providers, rather than defaulting to their pension provider's product. However, this development will also squeeze insurers' margins.

Further back-book consolidation likely

While for insurers such as Aviva, Legal & General and Scottish Widows, individual and bulk annuities remain core propositions, Aegon and Prudential have not only stopped selling annuities, but have divested annuity portfolios. Most recently, Prudential sold a £12 billion annuity book to Rothesay, while Phoenix acquired Standard Life Assurance, including its legacy annuity portfolio. Going forward, we see potential for further annuity back-book consolidation, especially if interest rates remain low. Sellers of annuity books will free up capital and improve their profitability, while buyers will benefit from added scale, while taking advantage of transitional relief under Solvency II.

Solvency II capitalisation is comfortable

Most UK life insurers' Solvency II ratios improved during 2017, with a number reporting ratios close to or above 200%. This is comfortably above the 100% threshold below which increased regulatory scrutiny is triggered (see Exhibit 5).

Exhibit 5

UK life insurers - Reported Solvency II Ratios

Group	IFSR	YE2017 Solvency II ratio: Shareholder's View	YE2017 Solvency II ratio: Regulatory View	Target Ratio	Transitionals
Aviva Plc[1]	Aa3	198%	169%	150-180%	✓ for technical provisions
Legal & General[1]	Aa3	189%	181%	> 140%[2]	✓ for technical provisions
Prudential Assurance Company Ltd	Aa3	178% (Shareholder-backed)[3] / 201% (With Profits)	142%	130-150% (Shareholder-backed)	✓ for technical provisions
Rothesay Holdco UK Ltd[1]	A3	-	169%	130-150% for Rothesay Life Plc[4]	✓ for technical provisions
Royal London	A2	228%	156%	not disclosed	✓ for technical provisions
Scottish Widows	A2	160%[5]	145%[5]	not disclosed	✓ for technical provisions

[1] IFSR refers to the main operating entities
[2] Legal & General discloses an internally set threshold for increased monitoring of 140%
[3] Pro forma estimated shareholders' ratio excluding sold annuity portfolio and transfer of the Hong Kong insurance subsidiary: 150%
[4] Rothesay Life Plc's YE17 SII ratio amounted to 163%
[5] Scottish Widows shareholders' view SII ratio refers to Scottish Widows Group's pre final dividend SII ratio, while the regulatory view SII ratio is net of foreseeable dividends
Source: Company reports, Moody's Investors Service

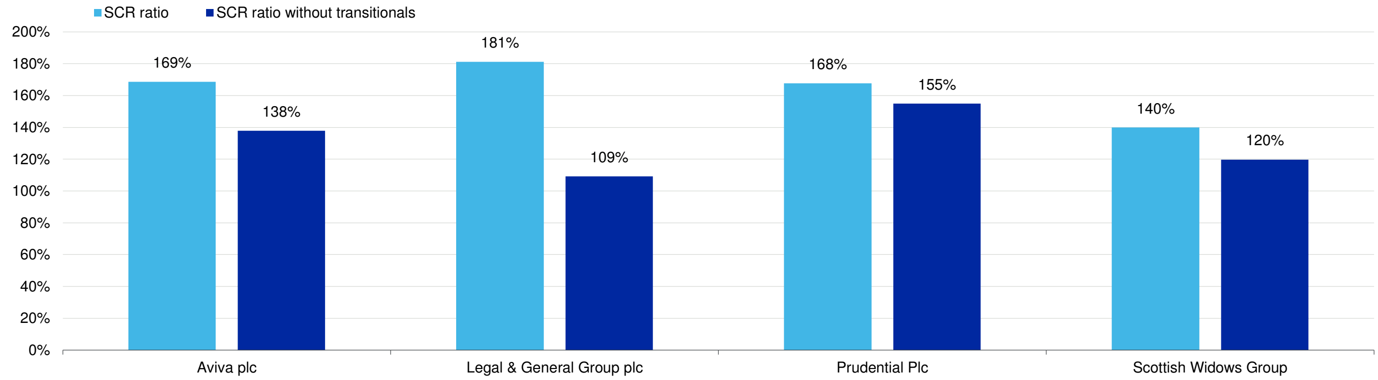
Significant reliance on transitionals and matching adjustment

UK life insurers' published Solvency and Financial Condition Reports (SFCRs) confirm the life sector's significant reliance on transitional measures on technical provisions (TMTP), which at a group level enhance the Solvency II ratio by a straight average of 34% points (see Exhibit 6). TMTPs are designed to soften the initial impact of Solvency II by allowing insurers to phase in over a 16 year period an increase in their technical liabilities.

Broadly and economically, we place little emphasis on Solvency II ratios with transitionals, but we also view ratios excluding transitionals ("fully loaded" ratios) as a less relevant measure of economic capital for UK insurers[1]. When analysing the capital position of UK insurers, we generally do not adjust the regulatory ratios given (i) the introduction of the matching adjustment (MA), as explained below, as a way to offset various shortcomings of a fair value approach and (ii) the UK's Prudential Regulation Authority (PRA) confirmation of the full capital benefit of TMTP when considering insurers' capital positions.

Exhibit 6

Technical provision transitionals enhanced UK-based life groups' YE17 Solvency II ratios



Source: Company reports, Moody's Investors Service

UK life insurers' comparatively high exposure to annuities means they are also heavily reliant on MA, a Solvency II mechanism which shields annuity writers from the impact of short term changes in the market value of their assets. This produces a capital benefit to the industry of some £66 billion[2]. The MA allows annuity writers, as buy-and-hold investors, to enhance the discount rate for their liabilities and therefore boost their own funds.

Regulatory review of Equity Release Mortgages could weigh on Solvency II ratios

While supportive of the MA framework, the PRA wishes to ensure that the MA is calculated correctly. It has become increasingly focused on how the MA is applied to Equity Release Mortgages (ERM), which allows retirees to generate an income or a lump sum from their accumulated housing equity. In July 2018, it published a consultation paper[3] setting out proposals on how to account for the property risk that life insurers carry from ERMs arising from no-negative-equity-guarantees (NNEG)[4].

The upshot of these proposals is that the matching adjustment of some UK life insurers most exposed to ERM may narrow, weighing in turn on their Solvency II ratios, despite generally low average loan-to-value ratios in the ERM market. PRA has acknowledged that the impact may be significant for some UK life insurers, and has said it would consider phasing in the changes over a period of up to three years. In this regard, we note that Just Group plc has stated that if the PRA's proposals are implemented as outlined, it could result in a material reduction in its capital position, and it has deferred any dividend declaration until it has greater clarity on its capital position.

If ERM business becomes more capital intensive as a result of the proposals which leads to less favourable pricing for retirees, then this could curb the UK ERM market's rapid growth which has to date been fuelled by growing demand from UK retirees.

Focus on risk margin post Brexit

When the UK leaves the European Union (EU), one area of focus will be the PRA's approach to the Solvency II risk margin. This margin, which represents the cost of future capital in the “going concern” approach built into Solvency II, is especially high for UK annuity writers, and is the main reason for their high dependence on TMTP. The PRA views the current risk margin as excessively sensitive to interest rates.

The risk margin and TMTP are running off at a broadly similar pace, there is a significant supply of reinsurance protection for longevity risk, and Solvency II does not appear to have pushed up annuity prices[5]. Nevertheless, it remains to be seen whether the PRA will attempt to fix what it sees as the flawed design of the risk margin. It is also unclear how this might affect the EU's decision whether to treat UK insurance regulation as equivalent to its own post Brexit.

Regulatory headwinds are likely to exacerbate margin pressure

The UK life sector is also under significant and increasing regulatory scrutiny as a result of the FCA's thematic focus on treating customers fairly. We expect this to continue for some years, with a potentially negative impact on margins.

Individual pension and income drawdown markets under spotlight

In February 2018, the FCA published a discussion paper on the UK individual pensions market, which comprises around £400 billion of assets under management. After assessing whether providers are competing on charges, and whether consumers require further protection, the FCA may follow up with measures in favour of the consumer and detrimental to insurers' margins, as was the case for workplace pensions.

In June 2018, the FCA also turned its spotlight on the retirement income market by launching a package of measures designed to protect consumers and promote competition. The regulator found that provider charges in the income drawdown market vary between 0.4% and 1.6%. It has not ruled out a cap on charges, which would negatively affect profitability.

Consumer-focused remedies proposed for platforms market

In July 2018, the FCA published interim findings of a review of the investment platforms market which revealed concerns about how platforms compete for certain groups of customers. The regulator proposed a number of measures which include helping consumers choose platforms on the basis of price, and making it easier for investors and advisers to switch platforms.

This could further erode the platform market's already low margins, and puts insurers with platform products under pressure to build scale. Platforms are expensive to develop, as illustrated by the increased cost of Quilter's UK platform transformation programme. We believe further consolidation in the market is likely, following Aegon's acquisition of Cofunds in 2016, and Scottish Widow's acquisition of Zurich's workplace pensions platform in 2017.

Platforms allow individuals and especially financial advisors to invest and manage their investments online, and serve as an increasingly important direct distribution channel for a range of savings and investment products. The UK platform market has been growing rapidly, reaching £604 billion of AUA at H1 2018, compared with £401 billion at YE15[6]. Pensions account for the largest share of platform AUA.

Insurers are increasingly building investment platforms, which customers can access either directly, or through intermediaries. This allows them to capture asset flows triggered by the structural shift in the pensions market and favourable stock markets.

FCA probes could lead to financial and reputational damage

The outcome of the FCA's various reviews could have negative financial and reputational consequences for UK life insurers. In 2017, the FCA's review of non-advised annuity sales practices led Standard Life Aberdeen and Prudential plc to increase their related provisions which at H1 18 respectively stood at £215 million (gross of any reinsurance recovery up to £100 million) and £400 million (gross)/£234 million (net of reinsurance). The review is ongoing and the ultimate outcome remains uncertain. The FCA also continues to investigate the behaviour of four firms regarding their disclosure to customers of exit and paid-up charges after December 2008.

There is also a risk that legislative changes may erode life industry margins and flows, as illustrated by past decisions to scrap compulsory annuities and reduce higher tax relief on pension contributions. Further changes to pension tax relief, for example, cannot be ruled out, including the taxing of pensions like ISAs, which would likely lead to reduced pension contributions from higher tax payers.

Brexit impact expected to be moderate, but uncertainty has increased

UK life insurers' capital and earnings have proved resilient since the UK's referendum vote to leave the EU in June 2016, and we continue to expect a moderate Brexit impact over the next 12 to 18 months. This expectation reflects our current base case that the EU and UK will conclude an agreement on transition and eventually agree on a final future relationship framework that has features similar to those of current trading and regulatory arrangements. This applies particularly to trading in goods.

Limited risk from loss of passporting

While UK financial institutions will lose their "passporting" right to operate in EU countries when the UK leaves the EU, we do not expect this to have profound implications for the insurance industry overall. This is because most UK life groups operating in continental Europe do so, or intend to do so, via local subsidiaries, which will be unaffected by the loss of their parents' passporting rights. In addition to writing new business, such subsidiaries could receive, via part VII transfers, existing policies written in the UK for policyholders in the European Economic Area (EEA). This transfer should reduce the uncertainty regarding the servicing of such policies post-Brexit.

We see limited regulatory risk to UK life insurers from Brexit over the next 12 to 18 months. In particular, we expect the UK's post-Brexit insurance regime to gain Solvency II equivalence, at least for an initial period, given the UK's close involvement in developing the Solvency II regime. However, in the event of a "no deal" Brexit[7],there will be more question marks over the Solvency II equivalence. And over the longer term, Brexit increases the risk of regulatory divergence between the UK and its former EU partners. This could reduce capital fungibility and increase regulatory costs for insurers operating in both jurisdictions.

UK GDP growth slowing but still positive

Although UK economic activity is slowing (see Exhibit 7), GDP growth is set to remain in positive territory. With interest rates rising and unemployment historically low, we foresee little impact on the UK life sector.

Exhibit 7

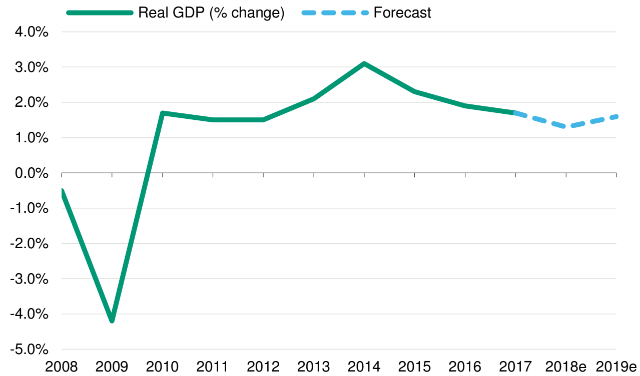
Business activity appears to be weakening alongside recent deterioration in consumption indicators

Indicator groups	Level vs. five-year average	Change since referendum	Most recent change	Key takeaways from indicator group
Business activity	Same	↘	↘	Compared with the five-year averages, business activity indicators have weakened somewhat and remain relatively weak against metrics at the time of the referendum. GDP growth remains muted at 0.2% in the three months ended in May, same rate as Q1 2018.
Investment sentiment	Same	↔	↔	Investment sentiment is near five-year averages and is overall in line with pre-referendum levels. Capital spending intentions appear to be diverging and overall investment growth has flattened.
Consumption	Below	↘	↘	Consumer indicators appear to be weighed down by expectations of rising unemployment in the next 12 months, in line with muted consumer services activity.
Trade	Same	↔	↔	Trade balance indicators are close to five-year averages. The UK's trade deficit has widened lately on falling export growth and is near pre-referendum levels, despite surveys suggesting export orders have risen thus far in 2018.
Prices	Same	↗	↔	Headline consumer price inflation and retail prices show some signs of stabilising, while the core inflation measure, which excludes volatile items such as food and energy, continues to fall, although it remains above pre-referendum rates.
Labour market	Same	↔	↔	Labour market indicators are near five-year averages and are in line with pre-referendum levels. However, hiring intentions, particularly for the services sector, have weakened, suggesting overall employment growth may be flattening.
Housing market	Below	↘	↔	Housing market indicators are still trending below five-year averages and have fallen since the referendum. Surveys suggest house price inflation could remain stable over the next three months.
Financial conditions	Same	↔	↔	Financial conditions are in line with five-year averages and pre-referendum levels. Bond yields have risen in 2018. Following the Bank of England survey, the availability of credit for both corporates and households is expected to worsen somewhat over the next three months..

Source: Moody's Investors Service, UK Brexit Monitor July 2018

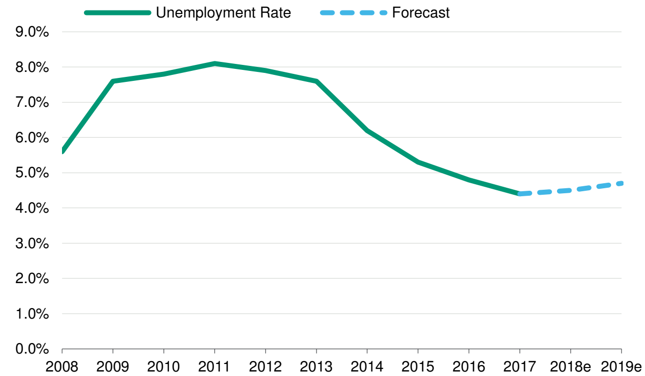
The effect of Brexit on the UK's GDP is becoming more pronounced, but remains more benign than pre-referendum forecasts. We expect GDP growth to fall to 1.3% in 2018 from 1.7% in 2017 (see Exhibit 8). The slowdown, combined with pressure on disposable household income, will weigh on UK life insurers selling discretionary products. However, we expect GDP growth to pick up to 1.6% in 2019, and forecast that UK unemployment – which fell to a historically low of 4.4% in 2017 – will remain below 5% in 2018.

Exhibit 8
UK GDP growth rate slowing



Source: Moody's Statistical Handbook Country Credit - May 2018, Moody's Investors Service

Exhibit 9
Unemployment has fallen to historically low levels

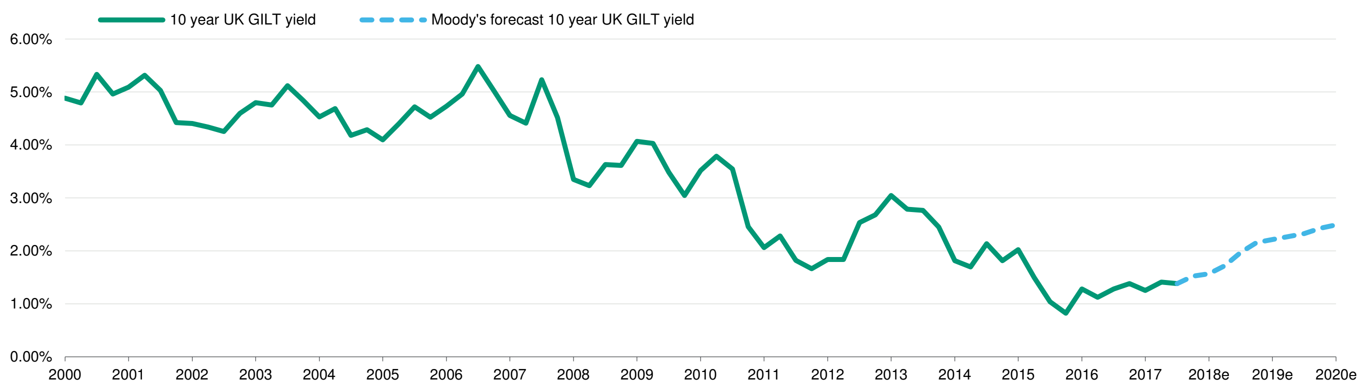


Source: Moody's Statistical Handbook Country Credit - May 2018, Moody's Investors Service

Gradual rise in interest rates is supportive

Low interest rates - the 10 year UK government bond yield remains low at around 1.5% - continue to weigh on UK life insurers' reinvestment yields and suppress investment returns. However, we expect the 10 year bond yield to gradually increase over the next two years, supporting the sector (see Exhibit 10).

Exhibit 10
UK gilt yield still low

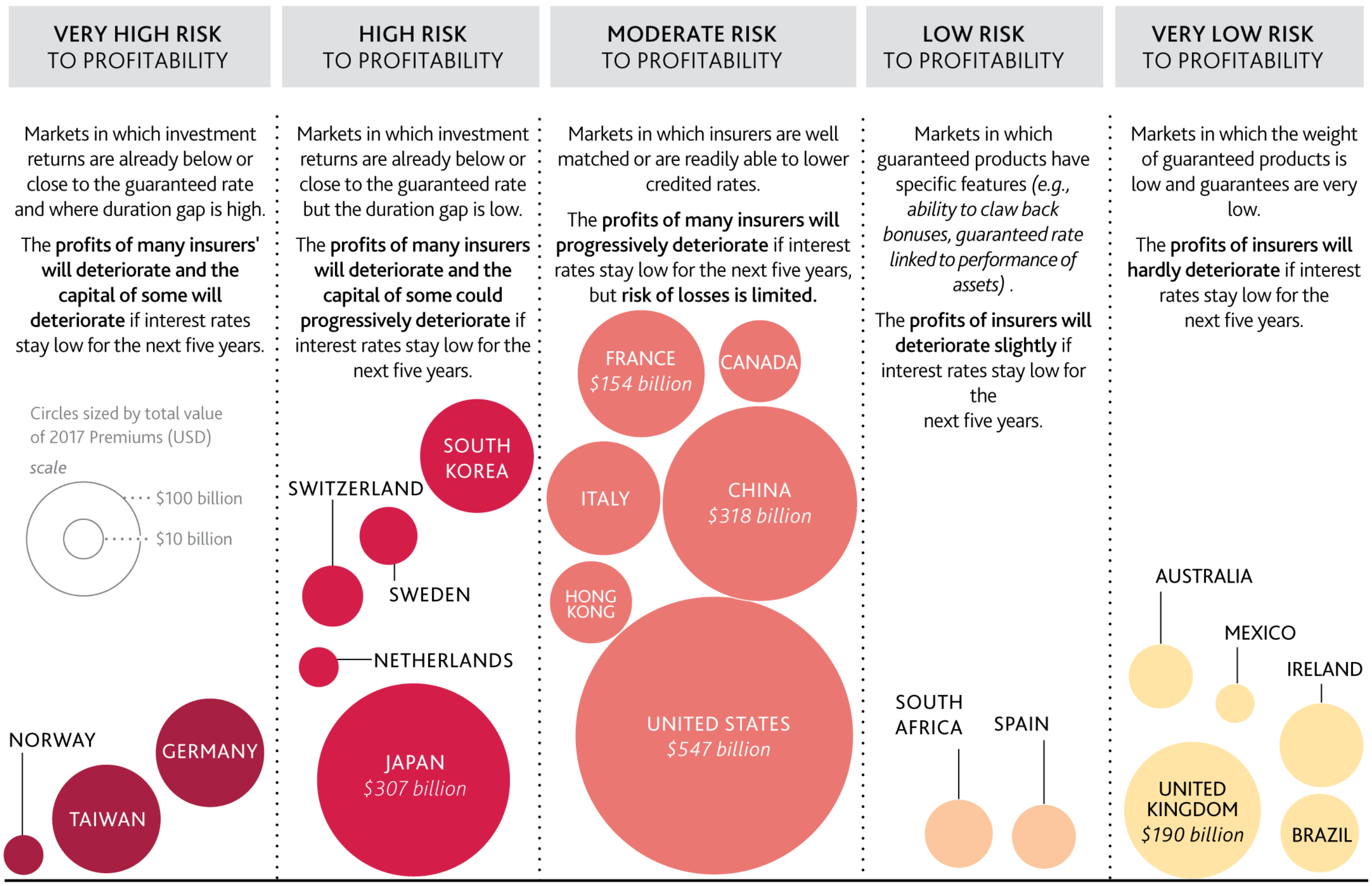


Source: Bank of England, Moody's Investors Service

We note that UK life insurers are less vulnerable to low interest rates than some of their European counterparts because they are not committed to paying guaranteed returns to policyholders, and there is minimal duration mismatch between their annuity assets and liabilities. We also consider UK life insurers to be less vulnerable to policyholder defections. This insulates them against competition from banks and asset managers in the event of a sudden spike in interest rates.

Exhibit 11

Low rates are a greater threat to insurer profitability in Germany than in the UK



This assessment is made at the country level and mostly focuses on the direct impact of low interest rates on profitability generated by in-force policies. However, not all insurers in each country face the same level of risk. Moody's insurance financial strength ratings reflect the specificities of each individual insurer. Please refer to moodys.com for research on Moody's-rated insurers.

Source: Moody's Investors Service

Brexit introduces economic uncertainty

However, the ongoing Brexit negotiations introduce a high level of uncertainty over the UK's economic outlook. There is now less time to avert a "no deal" Brexit, which could have negative implications for economic growth and financial markets.

In a "no deal" scenario, weaker GDP growth and a decline in house prices could drive down demand for life insurance savings and protection products. This would weigh on insurers' revenues, and potentially on their operating profits. At the same time, increased volatility in financial markets, including a fall in gilt yields, would weigh on the UK life sector's capitalisation, given its high asset leverage and material exposure to UK financial markets.

Moody's related publications

Credit Opinions

» Aviva Life & Pensions UK Limited

» Legal & General Group Plc

» Prudential Assurance Company Ltd

» Rothesay Holdco UK Ltd

» Royal London Mutual Insurance Society Ltd

» Scottish Widows Limited

» Government of United Kingdom

Industry Outlook

» Moody's: Global life insurance outlook changed to stable as earnings pressures lessen amid shift to fee-based products

» Moody's: Outlook for European insurance industry is stable, despite low rates challenges

Sector Comments

» Despite Rise, Still-Low Interest Rates a Threat To Profitability

» Solvency II Disclosures Shed Light On Areas of Future Regulatory Scrutiny

» New Solvency II disclosure confirms transitionals significantly enhance solvency ratios; our credit view has not changed

» UK Insurers' Asset Management Firms Set to Capitalize on Pensions Expertise

» UK Brexit Monitor - July 2018

Endnotes

1 Please refer to Moody's publication: "**Expectation of a moderate impact from Brexit drives stable outlook**", June 19, 2017

2 Please refer to PRA speech: "An annuity is a very serious business", 26 April 2018

3 Consultation Paper | CP13/18 Solvency II: Equity release mortgages July 2018

4 A guarantee that on certain forms of repayment any excess of the accrued loan amount above the (sale) value of the property will be written off or waived by the lender, subject to certain conditions.

5 Please refer to Letter from Sam Woods: Solvency II Risk Margin, 6 June 2018

6 Fundscape

7 A scenario in which the UK leaves the EU on 29 March 2019 without a fallback arrangement in place

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