

Insurance – Europe

2018 outlook stable as economic growth, financial stability and underwriting discipline partly offset low rates

NOVEMBER 23, 2017

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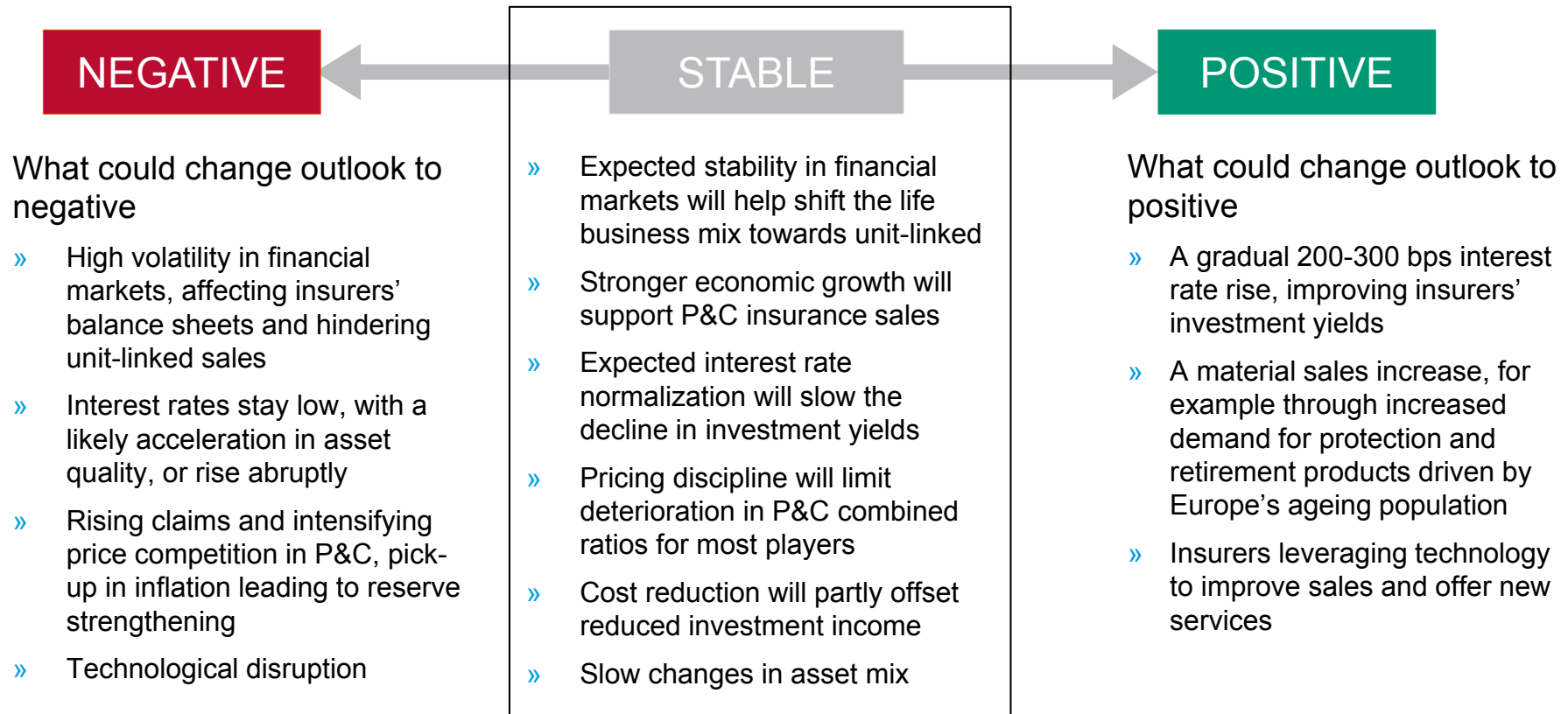
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2018 European Insurance Outlook - Stable



The Industry Outlook (positive, stable or negative) indicates our forward-looking assessment of fundamental credit conditions that will affect the creditworthiness of the insurance industry over the next 12-18 months. As such, the outlook provides our view of how the operating environment for the 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.

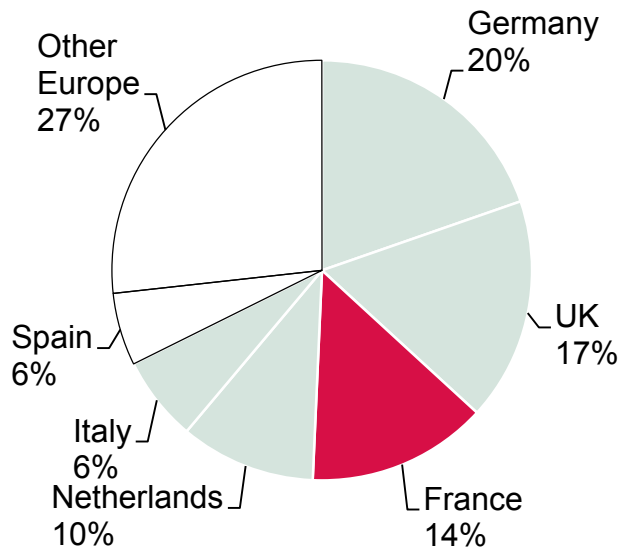
Insurers adapt to still low rates, helped by favourable economic conditions

Key credit themes

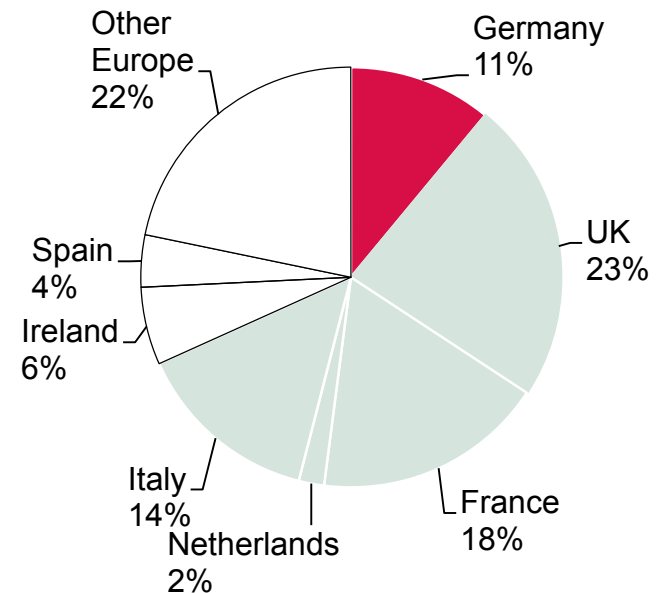
- » We expect continued economic growth and stable financial markets to support the European P&C and life insurance sectors over the next 12-18 months
- » We expect interest rates to rise gradually, but to remain historically low, weighing on insurers' profits; pockets of high risk remain, with some life insurers, e.g. in Germany, facing solvency pressures
- » Most European life insurers are adapting to low rates by reducing guarantees and focusing on sales of less risky unit-linked products, a credit positive trend we expect to continue
- » Reduced tax advantages for life insurance products expose life insurers to greater competition from other savings providers, weighing on sales and margins
- » Efforts to better manage in-force life liabilities, including through run-off, are preparing the ground for future consolidation
- » Most P&C insurers will remain disciplined on price, but we expect profits to fall as tough competition limits price increases, and as reserve releases slow
- » European insurers will continue to offset low interest rates through cost cuts and changes in asset mix, which will continue but at a slow pace
- » Geopolitical factors, flat or abruptly rising interest rates, technological disruption, and climate change are downside risks to our stable outlook

Stable outlooks on most European insurance sectors

Europe non-life premiums by country - 2016



Europe life premiums by country - 2016



Sources: Swiss Re Sigma No 3/2017, Moody's Investors Service

Outlook Key:



Supportive macroeconomic trends

Economic growth will support growth in P&C premiums, stable financial markets will underpin unit-linked sales

Growth



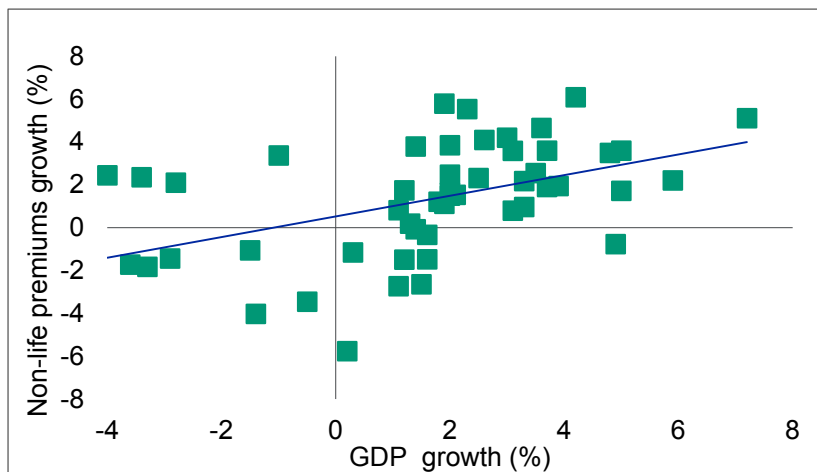
- » [We expect strong growth in advanced economies to continue into 2018 \(euro area: growth at around 2.0% in 2018, compared with 1.8% in 2016 and 2.2% expected in 2017\)](#)
- » Economic growth helps drive growth in P&C premiums

Financial stability



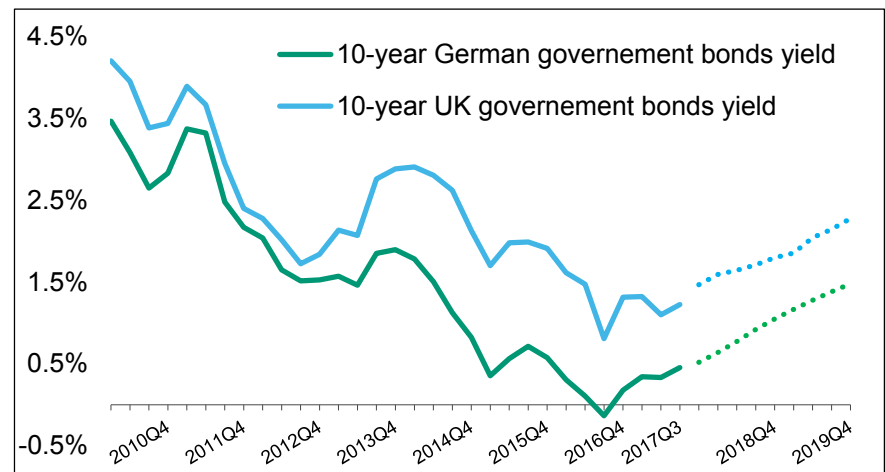
- » [Risk of financial market disruption or broad-based asset price correction is mitigated by an expected gradual rise in interest rates](#)
- » Strong financial markets support life insurers' strategy of developing their fee business
- » Expected increase in interest rates is credit positive for insurers

P&C premiums growth correlates with GDP growth



Sources: Swiss Re sigma report No 3/2017 (2004-2016 data of Germany, France, the Netherlands, Italy and Spain), Moody's Investors Service

We expect interest rates to increase gradually



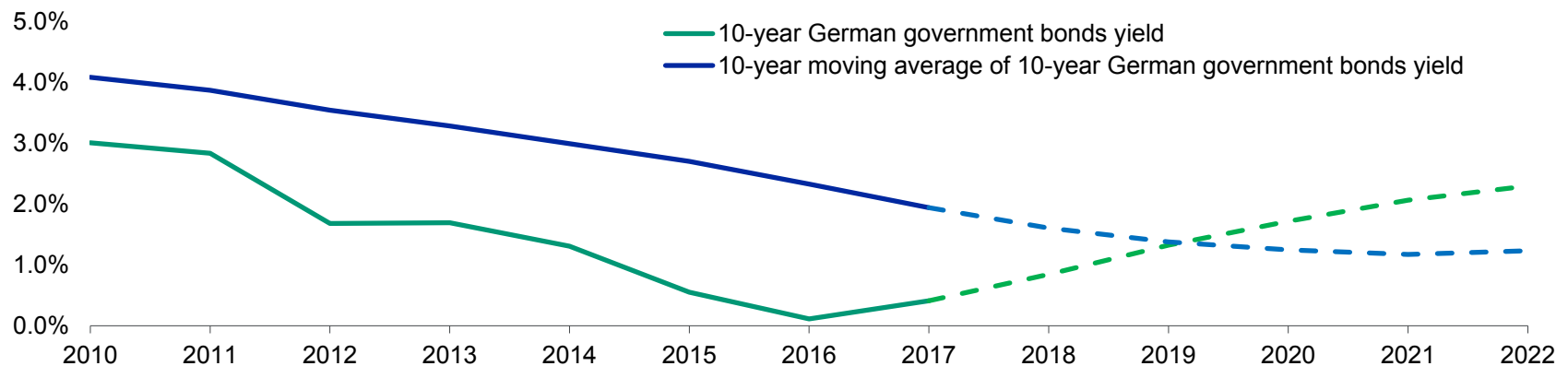
Sources: Deutsche Bundesbank, Bank of England, Moody's Investors Service forecasts

Despite rise, low rates still a challenge

Continued drag on profitability

- » Although rising, rates will remain below the yields that insurers generate on their assets, forcing them to (re)invest at lower rates, and putting their investment yields under continued pressure
- » We expect the investment income of European P&C insurers to fall by a cumulative €1 to €3 billion in 2017-2019, resulting in a decline in net profits of up to 10% over the three-years period
- » We expect the investment income of European life insurers to fall by €10 to €15 billion p.a. over the next two years, and to continue declining beyond 2019 if rates remain low
- » Most life insurers will share the decline in investment income with their policyholders, limiting the impact on their profits

Moving average of spot rates, a proxy for insurers' investment yields, will continue to decline despite increasing spot rates – the example of 10-year German government bonds



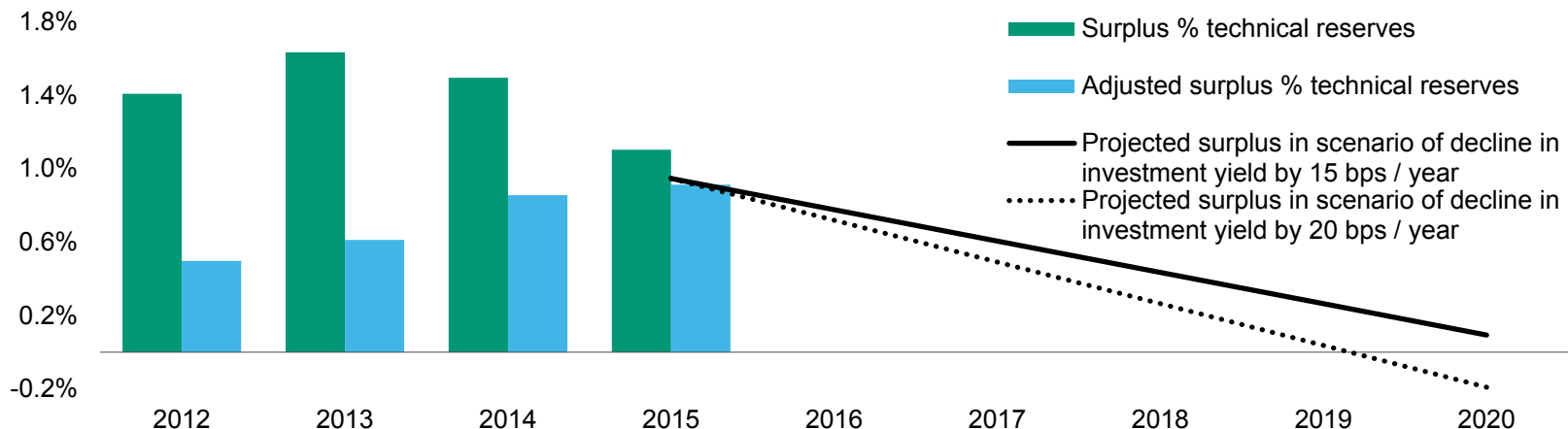
Sources: Deutsche Bundesbank, Moody's Investors Service forecasts

Solvency risks remain in some markets

Some life insurers will remain vulnerable if rates stay low

- » Investment yields are approaching or have fallen below guaranteed policyholder return rates for some insurers in Germany, Norway, the Netherlands, Switzerland and Sweden
- » Solvency pressures are particularly high in Germany, where around one third of life insurers have a Solvency II ratio below 100% without transitional measures (year-end 2016 figures)
- » We expect the overall result of the German life market to turn negative by 2020 if interest rates remain low

German life insurers' pre-tax profit, before profit sharing with policyholders



Surplus: income in excess of guarantees; before profit sharing with policyholders; includes investment income as well as technical result and expense result / Adjusted surplus: surplus adjusted for realised capital gains and for additional interest rate reserve (ZZR) financing

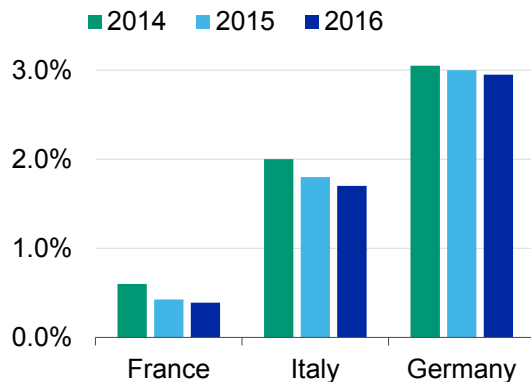
Sources: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Moody's Investors Service

Life insurers adapt products to low rates

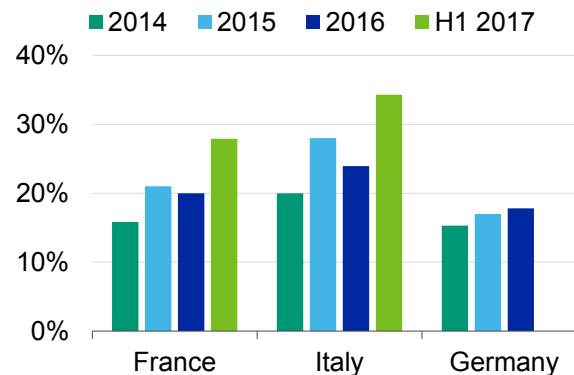
We expect a continued shift towards unit-linked sales

- » Insurers are reducing guarantees on new business, leading in some cases to a negative guaranteed rate (e.g. in France), reducing the average guaranteed rate on the business as a whole
- » New product designs reduce risks (e.g. policies that pay guarantees at maturity only)
- » Stronger shift to less risky unit-linked products encouraged by strong financial markets
- » Weight of unit-linked will continue to increase as smaller insurers join larger peers in the strategy to boost unit-linked sales
- » New business is much less sensitive to interest rates, a credit positive

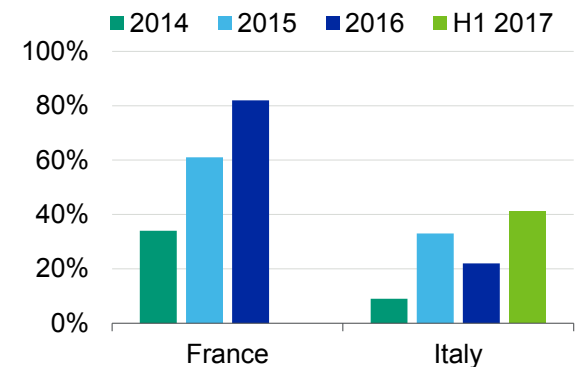
**Average guarantee rate
(traditional life insurance)**



Unit-linked business % premiums



Unit-linked business % net flows



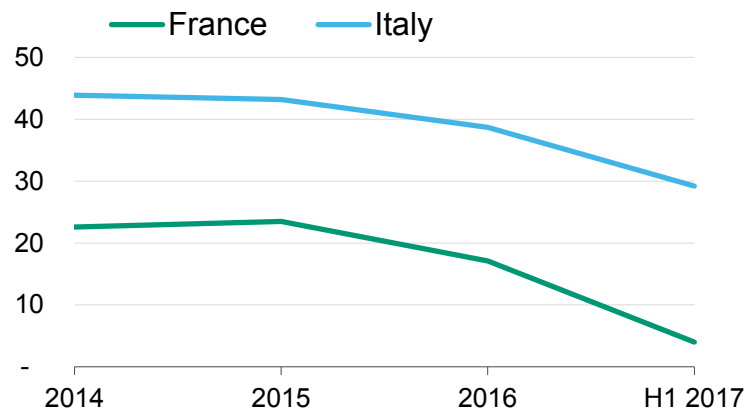
Sources: Fédération Française de l'Assurance, Autorité de Contrôle Prudentiel et de Résolution, Associazione Nazionale fra le Imprese Assicuratrici, Istituto per la Vigilanza sulle Assicurazioni, Bafin, Gesamtverband der Deutschen Versicherungswirtschaft

New products less attractive to customers

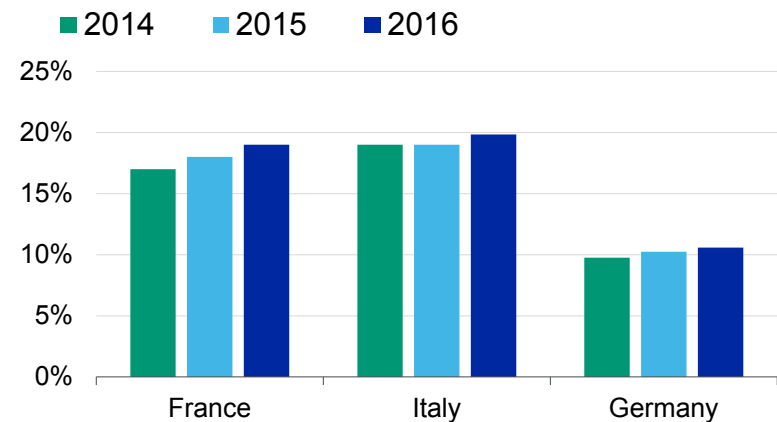
Volumes will likely remain below historical levels

- » Life products with lower or no guarantees (unit-linked) are less attractive to policyholders
- » Life insurers target increased sales of protection products and retirement solutions on the back of Europe's ageing population, but protection volumes remain low
- » Overall sales or net flows volumes will likely remain below historical levels in 2018-19 in many countries
- » Low new business volumes slow the positive impact of product mix changes on balance sheets, and call into question insurers' ability to maintain current profitability levels

Yearly net flows (€ billion)



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

Insurance products are becoming more like other savings products...

- » Insurers' unit-linked or low guarantee products are very similar to banking or asset management products (deposits, mutual funds)
- » Tax advantages of insurance products compared with other savings products are diminishing

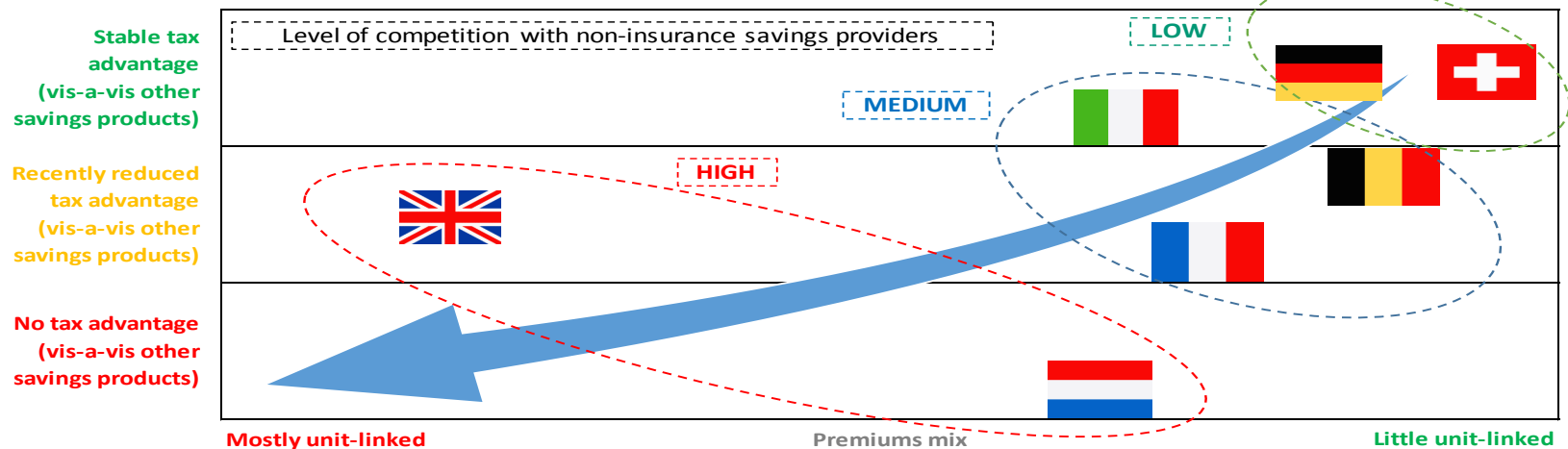
Netherlands (2008): Banking products attract the same tax treatment as insurance products

Belgium (2013): Tax on life insurance premiums increased

UK (2016): Reduction in tax-free limit on pension contributions

France (2017): Flat tax introduced for all savings products

The tax advantage of insurance products is decreasing, increasing competition from other savings providers



NOTE: The vertical axis does not compare the level of tax advantage in each country, but focuses on recent changes

Sources: European Insurance and Occupational Pensions Authority, Die Nederlandse Bank, Fédération Française de l'Assurance, Associazione Nazionale fra le Imprese Assicuratrici, Banque Nationale de Belgique, Swiss Insurance Association, Moody's Investors Service

... challenging insurers in the savings market and pressuring their margins

- » Protection features will remain a key differentiator for insurance products, but insurers may struggle to stand out and grow their market share in the savings space
- » Insurers' strategies for capturing a greater share of savings flows vary by country:

UK

Insurers are growing their asset management business
Some insurers are becoming asset managers (e.g., Standard Life Aberdeen)

Netherlands

Insurers are growing in banking and in asset management

France / Italy

Insurers combine guaranteed and unit-linked features within the same product

Germany

Insurers continue to sell mostly guaranteed products, but with guarantees paid only at maturity

- » Increased competition between savings providers is likely to pressure margins

Consolidation proceeds despite obstacles

- » Small M&A deals possible as large groups rationalise their international presence (e.g., Generali and AXA to focus on countries where they have scale)
- » Insurers are placing a growing number of life businesses into run-off, notably in the Netherlands and in Germany, paving the way for future consolidation, as in the UK
- » However, high risk in Dutch and German legacy books constrains consolidation



Selected examples in the UK:



- » Friends Life included a large run-off portfolio
- » 2005: Zurich UK annuity in quasi run-off
- » 2010: Aegon UK annuity in quasi run-off



- » 2015: Aviva acquired Friends Life
- » 2015: Zurich sold annuity portfolio to Rothesay
- » 2016: Aegon sold annuity portfolio to Rothesay/L&G



Since 2008, most Dutch life insurers have closed their traditional individual life and group operations to new business



- » 2017: NN Group acquired Delta Lloyd
- » 2017: ASR acquired Generali Nederland
- » **To be continued...**



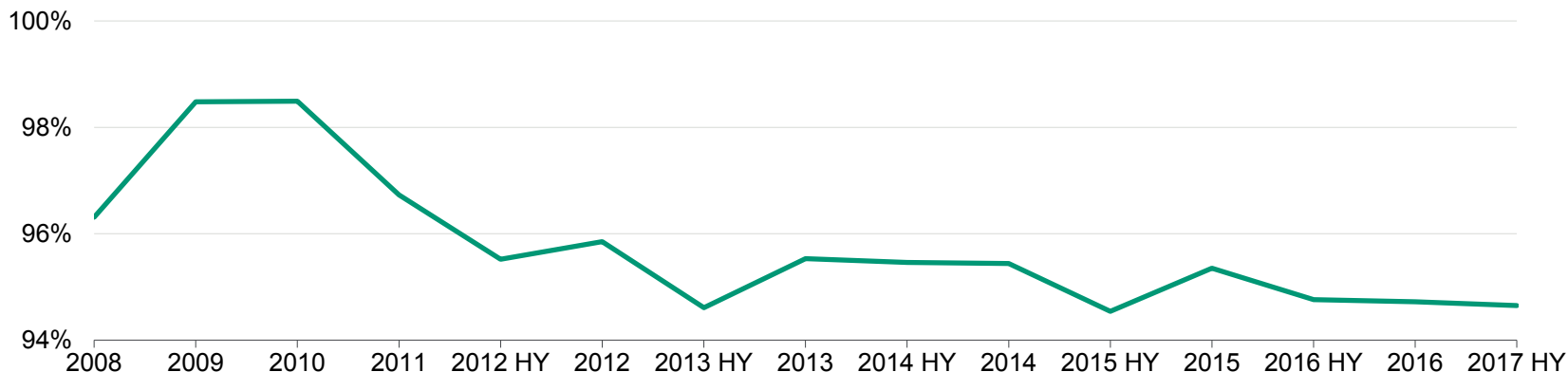
- » 2009: Victoria Leben in run-off
- » 2012: Baloise German life business in run-off
- » 2016: ERGO Leben in run-off
- » 2017: Generali Leben in run-off



- » 2017: Frankfurter Leben acquired Baloise's closed book
- » **To be continued...**







Strong combined ratios to deteriorate

Average P&C combined ratio reported by selected large European insurers



Sources: Ageas, Allianz, Aviva, AXA, Generali, If P&C, Mapfre, RSA, UnipolSai, Zurich Insurance, Moody's Investors Service

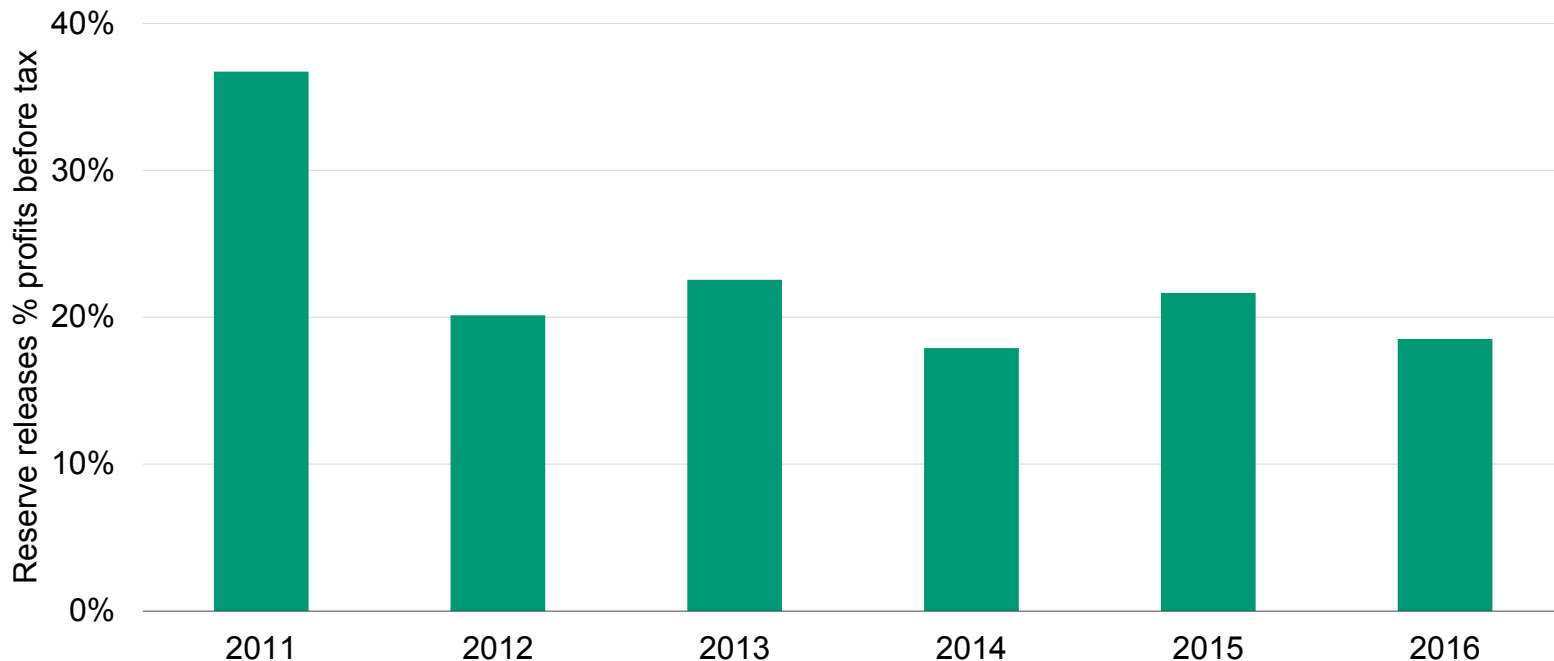
- » We expect P&C insurers to remain disciplined in their underwriting, but tough competition in most markets will curb their ability to raise prices and offset increase in claims
- » We expect combined ratios to deteriorate from current strong levels in most countries

Expectation						
Pricing	> 0	> 0	[+1% ; +3%]	[-1% ; +1%]	[-2% ; +0%]	[+0%;+5%]
Combined ratio	↑	=	= or ↑	↑	= or ↑	↓
2016 ratio	96% (excl. Ogden impact)	95%	98%	90%	91%	101%

Reserve releases are a wild card

- » Reserve releases account for around 20% of European insurers' consolidated pre-tax profits
- » In many countries (e.g., [Italy](#), [UK](#)), reserve releases have reached unsustainably high levels

Reserve releases as a % of pre-tax profits for European insurers



Sources: Data disclosed by Direct Line, RSA, Aviva, Allianz, AXA, Zurich, Generali, Bupa, Mapfre, If P&C, Tryg AS, Ageas, Macif, Swiss Re, Munich Re, Unipol, Lloyd's of London, Moody's Investors Service

Cost cuts provide some support

Insurers will further reduce costs and leverage new technology, initially offset by restructuring charges and investments

AXA group, 14 November 2017

Refocusing the role of the corporate center contributes to cost efficiencies

- ✓ 25% reduction in central functions costs
- ✓ Cost efficiencies phased over the next 2 years: Euro 0.3 billion

Generali group, 16 March 2017

Revised ambition to achieve cost savings target one year early: mature market cost reduction of €200m to €5.3bn to be delivered by FY2018 (previously: FY2019)

Zurich Insurance, 9 February 2017

Actions underway to achieve USD 400m in net cost savings

USD 500m in restructuring costs expected

Aegon, 17 February 2017

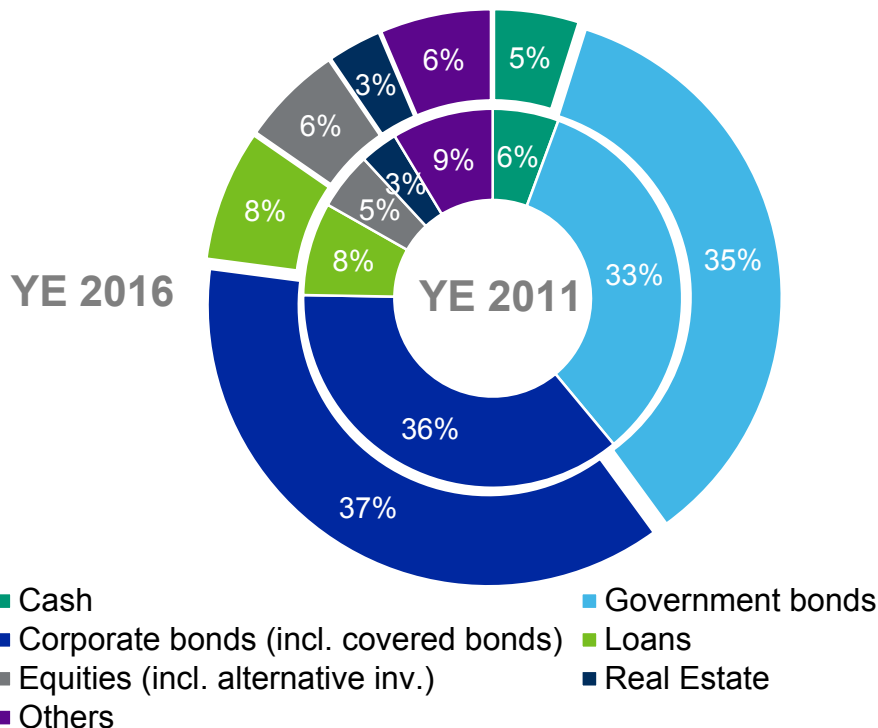
As announced in December, we have increased our 2018 expense savings target by EUR150 million to a total of EUR350 million.

To support this target, we've taken significant management actions in the fourth quarter (closure of three locations, net reduction of more than 500 roles...)

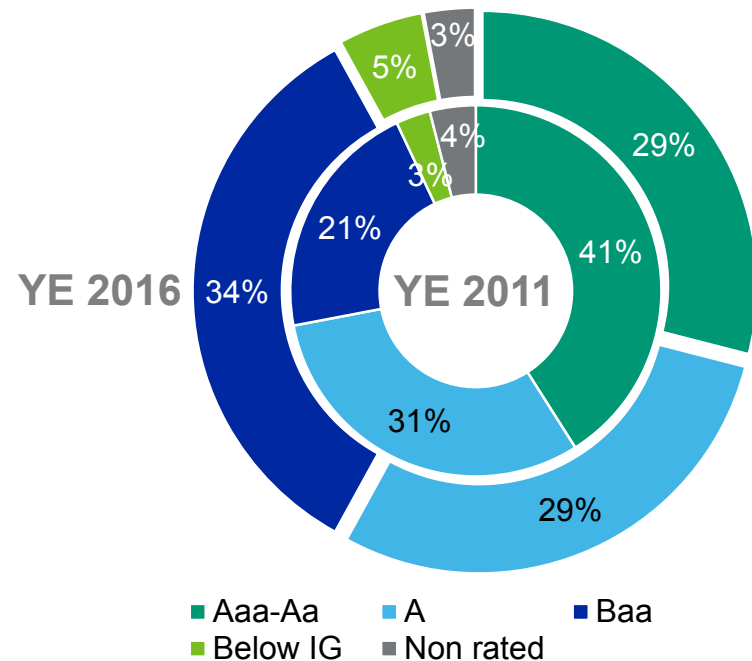
Slow changes in asset mix

Insurers will invest more in illiquid assets, but difficulties in sourcing such assets will limit the pace of change

European insurers' asset mix remains broadly stable



Quality of corporate bond portfolio deteriorates



Sources: Data disclosed by Aviva, Allianz, AXA, Aegon, Zurich, Generali, Munich Re, Moody's Investors Service

Downside risks remain elevated

Many factors could threaten the stability of ratings



**Political and
geopolitical risk**



**No increase in
rates**



Spike in rates



**Technology
and innovation**



**Climate
change**

- » Geopolitical risks in Europe (e.g. Brexit, Italian elections) or globally (e.g. North Korea) could hold back economic growth and create volatility in financial markets
- » Rates remaining flat at current levels would further pressure European insurers' profitability and would likely accelerate deterioration in their asset quality
- » An abrupt spike in rates would also be a risk for life insurers, particularly in France and Italy; a rise in inflation could result in an increase in P&C insurers' reserves
- » Technological disruption could affect traditional players' profitability and business models
- » Climate change could increase the frequency and severity of P&C claims: this would be negative if insurers were unable to increase prices to cover additional claims costs



Appendix

Main European life markets - overview

Stable outlooks for the main markets with the exception of Germany

Outlook Key:

NEGATIVE

STABLE

POSITIVE

UK

- » Brexit impact will likely be moderate
- » Life insurers' business model positions them strongly for long-term shifts in the sector
- » UK life insurers are less vulnerable to low rates than European peers
- » Solvency II capitalization is comfortable, but regulatory headwinds persist

France

- » Low interest rates negatively affect investment income, but insurers can largely offset this by lowering credited rates to policyholders
- » Shift towards unit-linked products is accelerating
- » Low level of net flows due to a structural increase in outflows and subdued inflows

Germany

- » Low interest rates will continue to erode life insurers' profits
- » Investment yields are converging towards guaranteed rates
- » Around one third of life insurers had to submit a solvency remediation plan to the regulator
- » Changes in business mix and regulatory pressures will intensify but it will take time to strengthen balance sheets

Italy

- » Low guarantees limit risks from low interest rates
- » Sales of unit-linked will continue to grow thanks to Italy's strengthening economy and improving global macro-economic conditions
- » High sovereign exposure constrains insurers' credit profiles, despite good solvency ratios

Netherlands

- » Economic conditions supportive, but operating environment is challenging
- » Significant efforts to address weaknesses and re-focus on core businesses
- » Consolidation likely to continue
- » Mis-selling dispute constrains unit-linked growth
- » More onerous Solvency II capital requirements than many European peers

Main European P&C markets - overview

Stable outlooks in most markets

Outlook Key:

NEGATIVE

STABLE

POSITIVE

UK

- » Underwriting profitability to remain robust
- » Rising claims inflation and falling reserve releases to pressure profitability
- » Low interest rates constrain earnings
- » Capitalization to remain healthy; moderate downside risk from Brexit

France

- » Combined ratios at around 100%
- » Fierce competition limits price increases
- » Low interest rates add further pressure on profits

Germany

- » Price increases tapering off after years of significant increases
- » Combined ratios to be relatively stable
- » Low interest rates constrain earnings
- » Moderate but steady economic growth supports stable outlook

Italy

- » Motor insurance likely to record a loss in 2017 leading to gradual stabilisation of prices
- » Combined ratios will likely increase, but from a level well below 100%, allowing P&C insurers to remain profitable
- » Reserve releases likely to taper off

Netherlands

- » Combined ratios consistently above 100%, with fierce competition especially in motor
- » Recent price increases to improve underwriting performance
- » Economic conditions supportive of insurance demand



Credit conditions will improve as global economy strengthens

Global credit conditions will improve in 2018 as economic growth picks up and low interest rates keep funding costs under control. Risks to this favorable outlook include the buildup of corporate leverage globally after a decade of low interest rates, the potential for a sizeable and synchronous equity and asset markets adjustment, and continued political and geopolitical uncertainty. In addition, a number of credit challenges loom, including disruptions from new technology, population aging and climate change.

Learn more: [moodys.com/2018outlooks](https://www.moodys.com/2018outlooks)

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