



Global Investment Research

European insurance – an analyst's view

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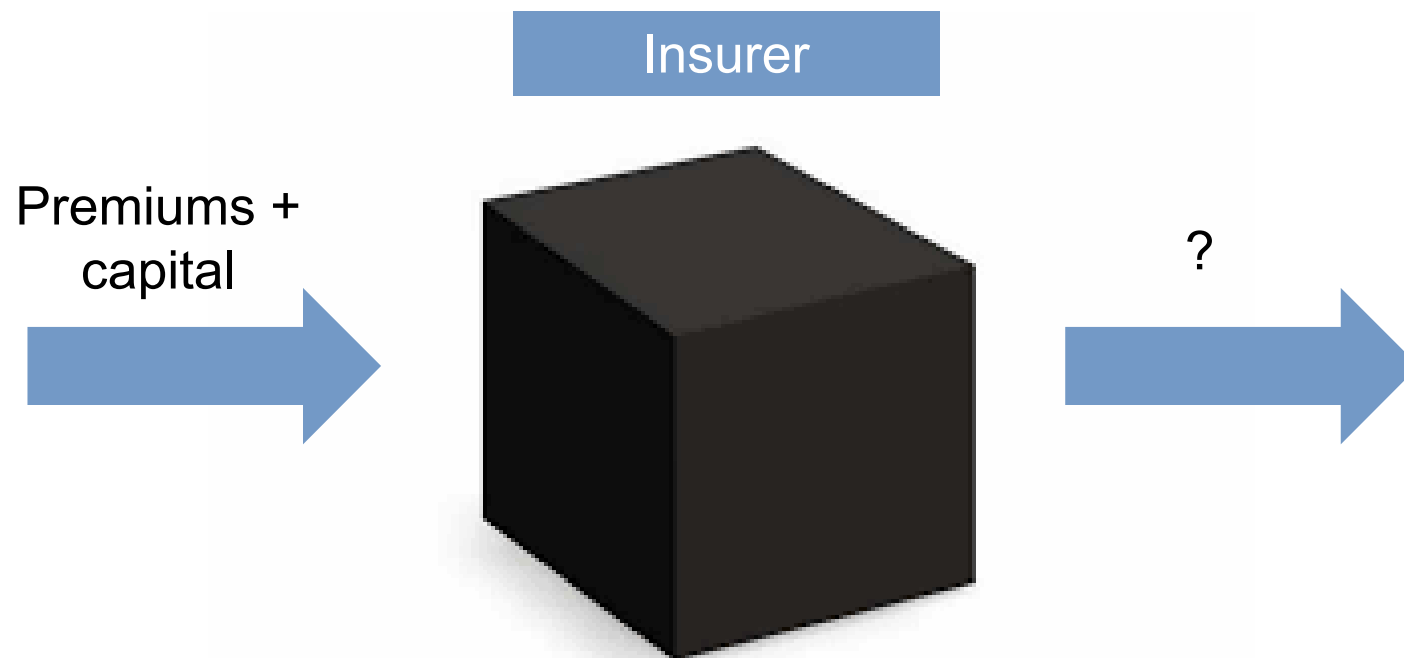
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Many investors see insurance as a black box

European insurance – an analyst's view



Presentation overview

European insurance – an analyst's view

- Equity markets – what you need to know
- Sector themes – opportunities and challenges
- Case studies
- Conclusions

The traditional view of the market has limitations

Equity markets – all you need to know

Equity value = NPV of cash flows

The traditional view...

Cash flows based on consensus
EPS/DPS expectations

Risks are reflected in the cost of
equity

...has some practical limitations

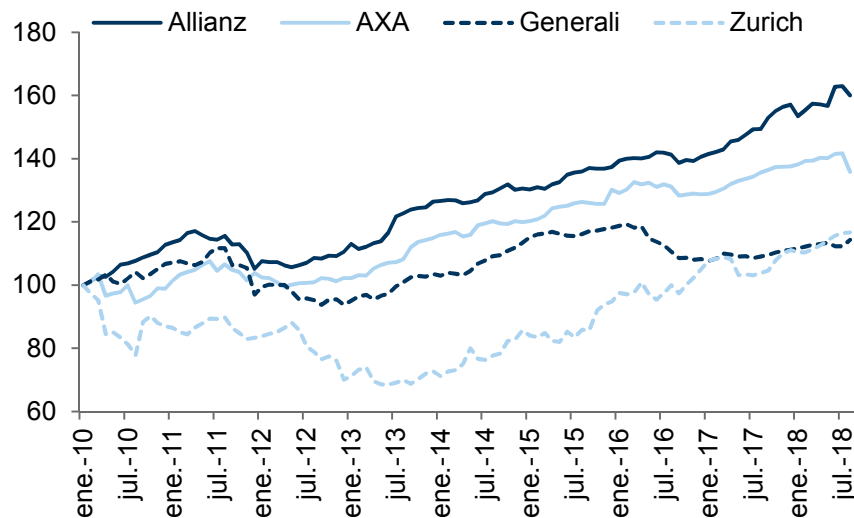
IFRS EPS and book value metrics
are not “economic”

The market does not wait around for
changes in consensus estimates

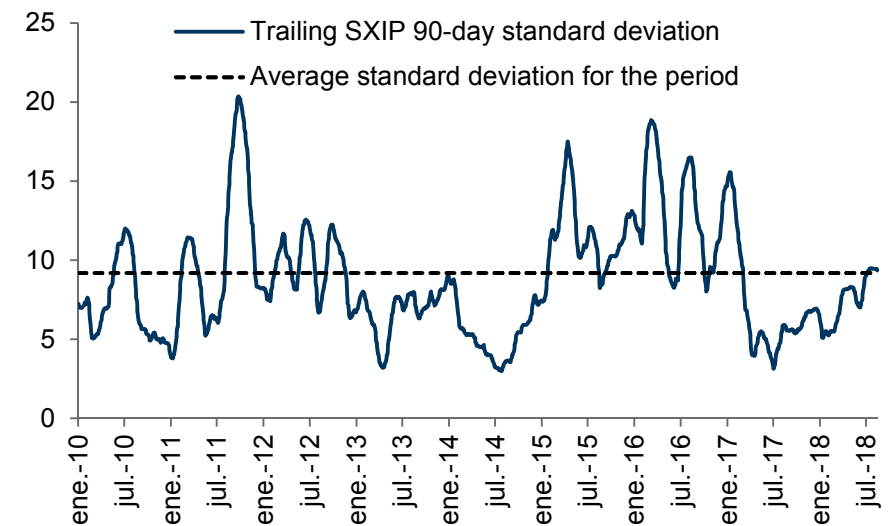
The market moves faster than accounting profits

Equity markets – all you need to know

Indexed 12-month forward consensus net income



Share price volatility



An economic view of equity value

Equity markets – all you need to know

Economic net asset value

+

Economic profits

Expected surplus

—

Cost of risk

Return in excess of the cost of risk

Recognised on expectation

Risk spread

Return on risk held

—

Cost of liabilities on balance sheet

Return commensurate with the cost of risk

Recognised on emergence

IFRS earnings are a mix of economic profits and risk spreads -> not all IFRS profits are the same

Key themes in European insurance

Key sector themes - challenges & opportunities

Macro themes

Low growth

Low interest rates

Shifting demographics

Political uncertainty

Micro themes

New technology

M&A/simplification

Regulation

Capital returns

In summary...

...the market environment is seen as challenging but with some potential opportunities

How will new technology affect the industry?

Key sector themes – new technology

Clear conclusions

Potential for operational improvements

Risk exposures will change

Insurers that do not adapt will fail

Uncertainties

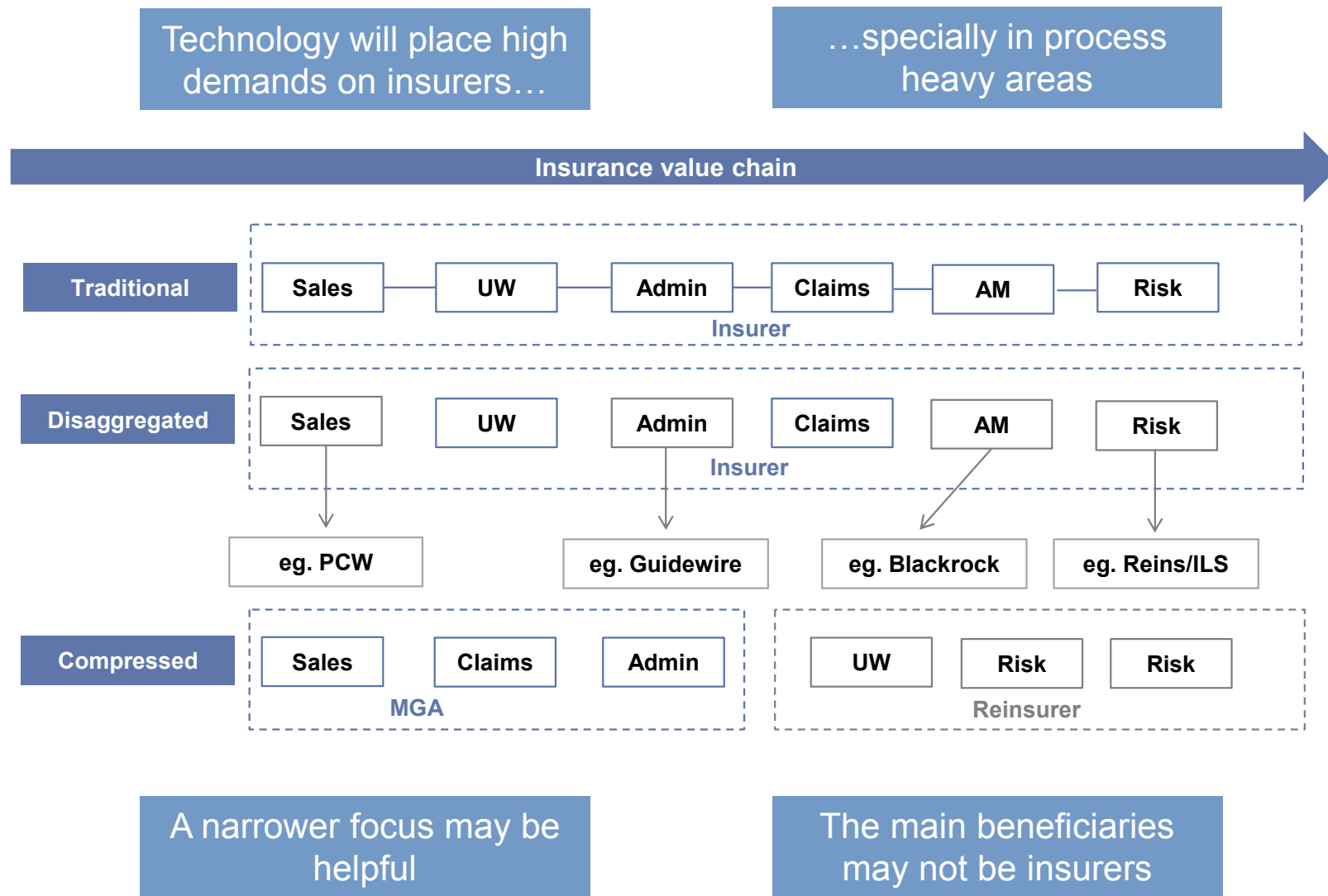
Is there risk of disruption?

How will legacy issues be resolved?

Who will be the main beneficiaries?

Re-modelling the insurance value chain

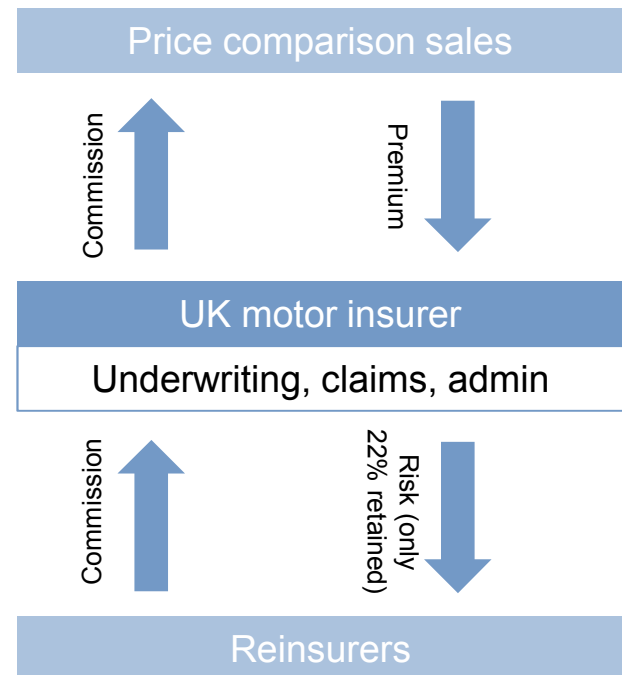
Key sector themes – new technology



A modern UK motor insurer

Case study – new technology

- UK motor insurance distribution is dominated by price comparison websites
- The insurer makes money at a low price point due to operational and capital efficiency
- Hence, the insurer is able to deliver economic profitability in a competitive market



Ageing populations

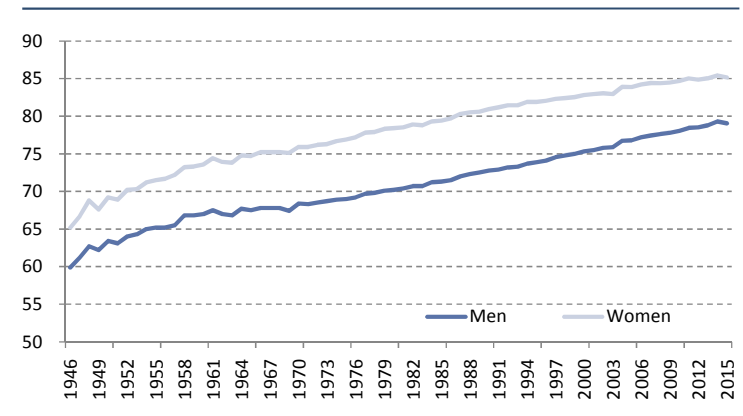
Key sector themes - demographics

- Rising life expectancy and lower birth rates have transformed developed world demographics

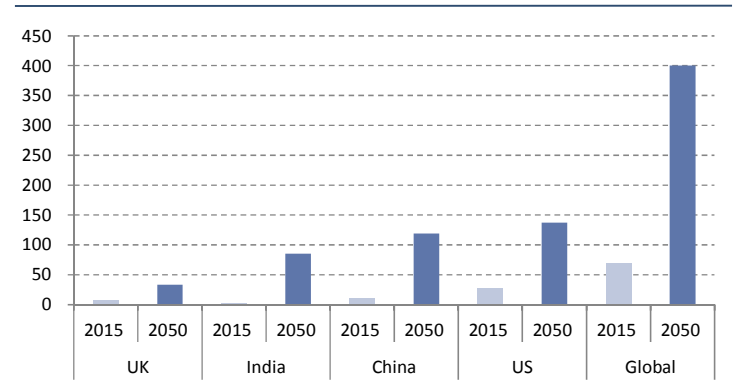
- New solutions are needed across the protection and savings landscape...

- ...and legacy liabilities need to be managed

Life expectancy in France (years at birth)



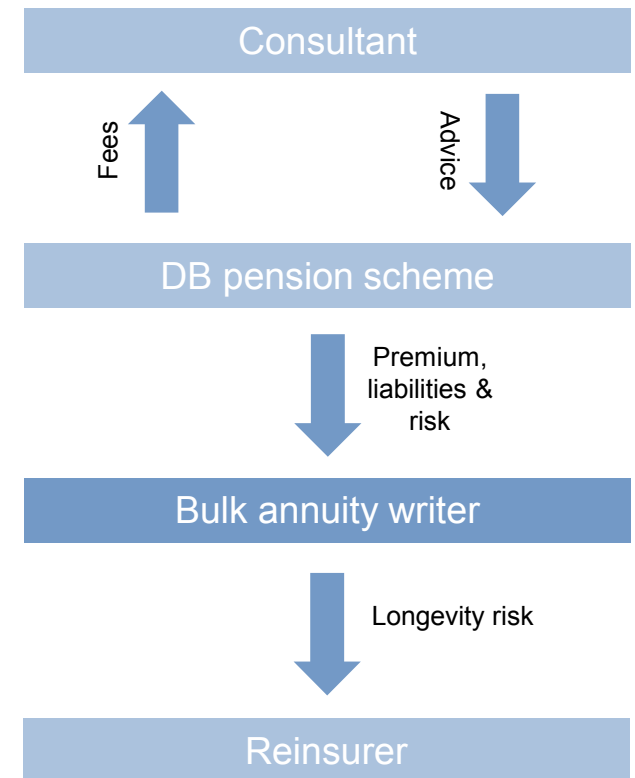
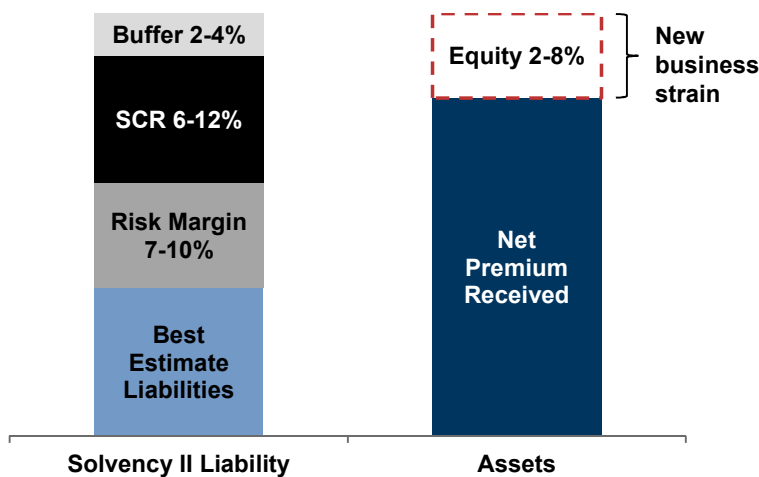
Estimated retirement savings gap (\$tn)



A UK bulk annuity writer

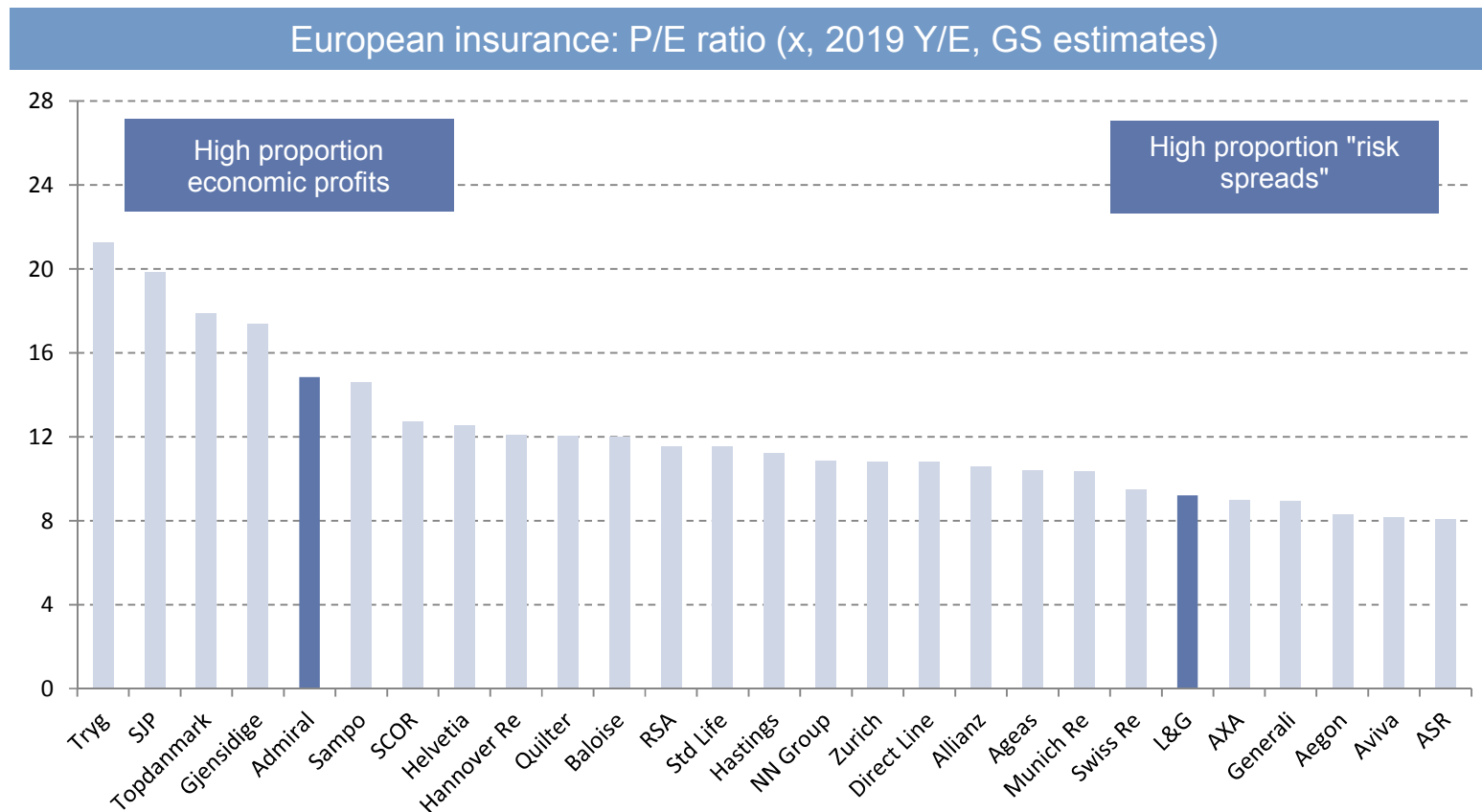
Case study – demographics

- Defined benefit pension obligations weigh on corporate balance sheet, particularly in the UK
- The bulk annuity writer assumes liabilities against an upfront payment
- However, what is discounted in pricing? What drives capital generation?



Profits create value, not investment themes

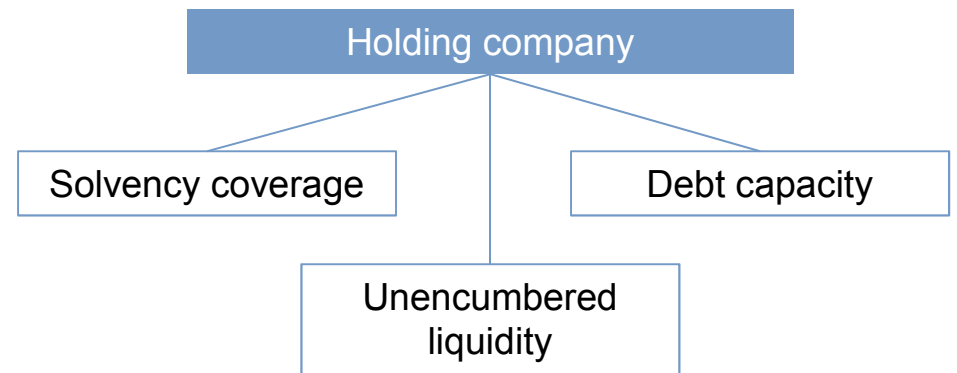
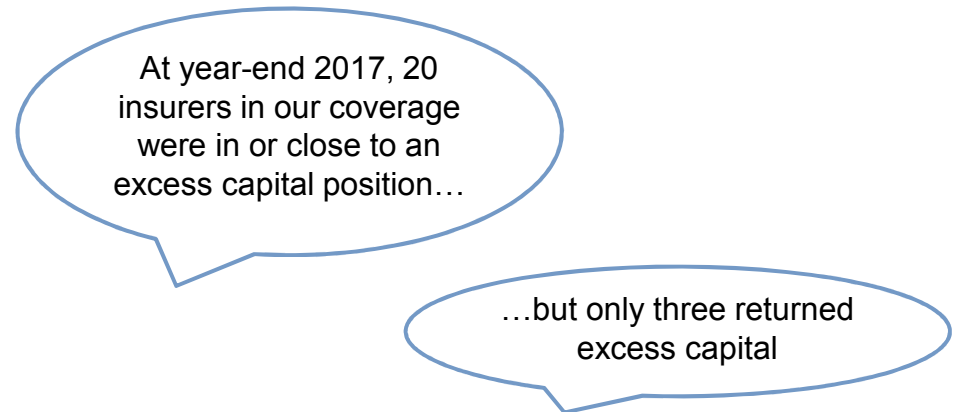
European insurance company valuations



Capital returns increasingly in focus

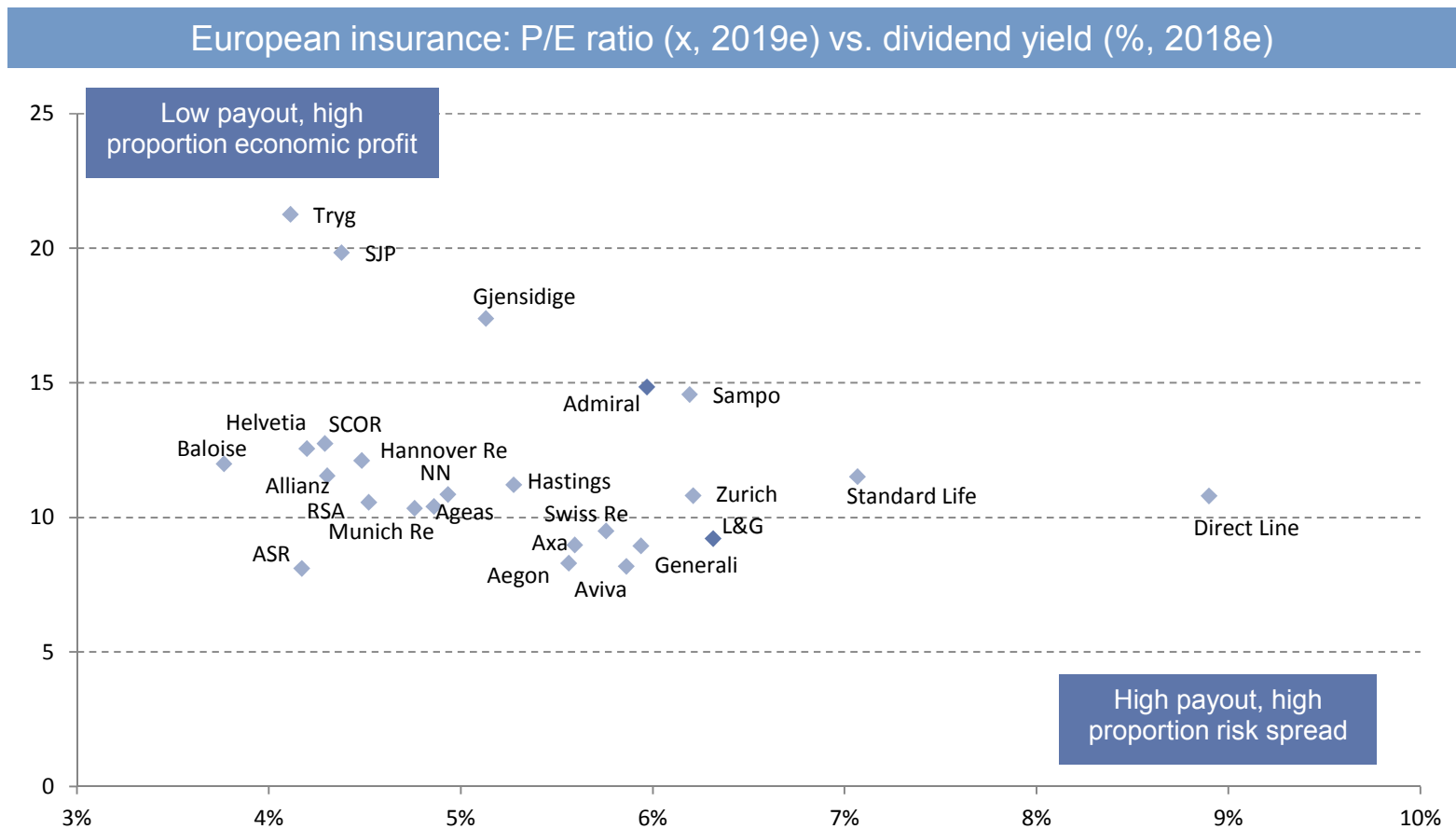
Key sector themes – capital returns

- Given the lack of growth, capital returns are key to the insurance value proposition
- To understand dividend capacity we need to look beyond solvency and earnings metrics
- Capital returns alone will not deliver value for shareholders



Capital returns alone do not create value

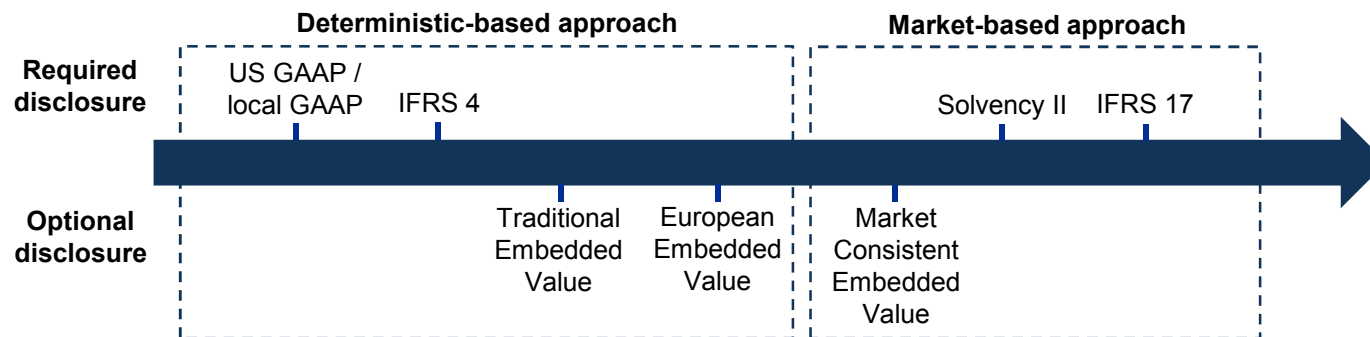
European insurance company valuations



Disclosures – moving in the right direction

Communicating insurance

- If the market is assessing insurers on an economic basis, surely disclosure should be economic?
- IFRS17 moves economic disclosure in the right direction...
- ...but is it more informative than Solvency II?



Conclusions

How insurers create value for investors

Insurance is a black box for most investors but the market as a whole understands it quite well

There are no obvious tailwinds but plenty of challenges

To create value for investors insurers need to offer economic profits or access to underwriting risks

Q&A

Disclosure Appendix

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