OLIVER WYMAN

Financial Services

POINT OF VIEW

MAXIMISING VALUE FROM THE IN-FORCE BOOK

A SYSTEMATIC APPROACH TO UNLOCK THE IN-FORCE OPPORTUNITIES

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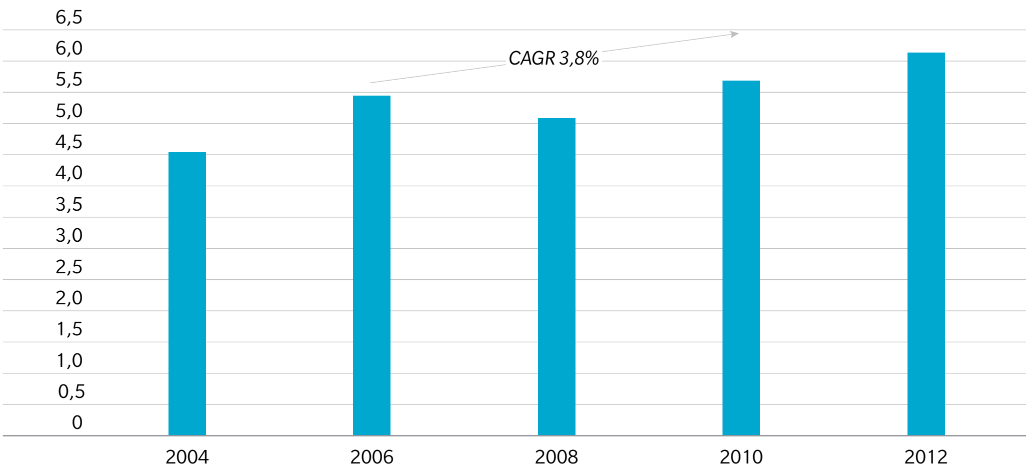
Life insurance is a mature business and profitability in many markets is still below pre-crisis level. Making the most of the in-force book can unlock substantial value: 7-10 bps of the reserves in additional operating profit and, potentially, much more if effective in-force management becomes part of business as usual. Many insurers have started re-examining their in-force books, however only few have been able to maximise the opportunity. In-force optimisation projects are indeed not easy, among others, being systematic, transversal and be willing to challenge the status quo are key.

1. THE OPPORTUNITY: CAPTURING MORE VALUE FROM THE IN-FORCE

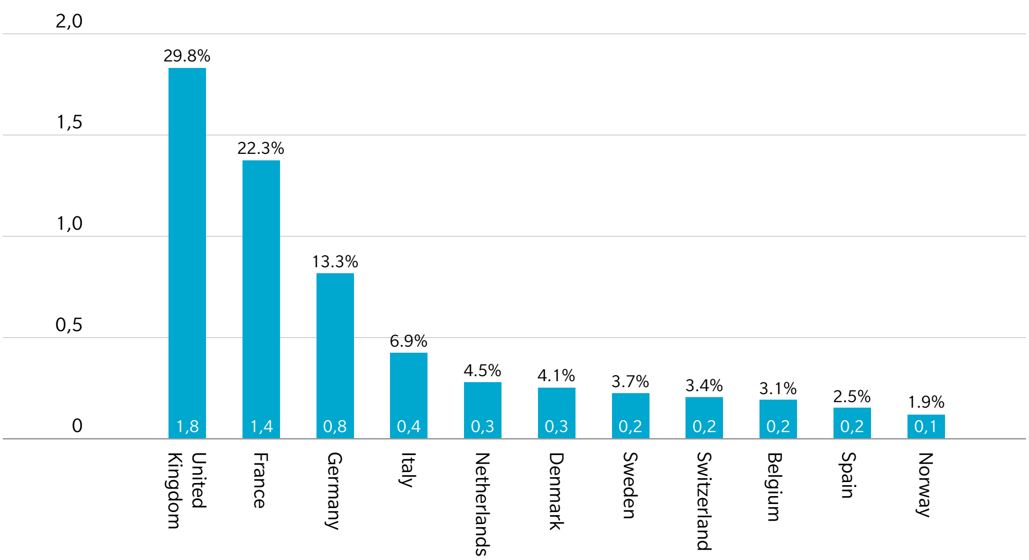
From 2004 to 2012, Life in-force in Europe has grown by 35%[1] despite a 10% drop in 2008 caused by the financial crisis. At the end of 2012, Life in-force gross provisions were €6.2TN, with UK, France and Germany accounting for two thirds of this volume. On average 36% of the in-force is unit-linked (with significant differences across countries, from 7.6% in Switzerland, to 50% in Finland and Poland).

Exhibit 1:

LIFE GROSS PROVISION AT YEAR END (2012) IN €TN



LIFE GROSS PROVISION AT YEAR END IN €TN



PERCENTAGE OF EUROPE GROSS PROVISIONS

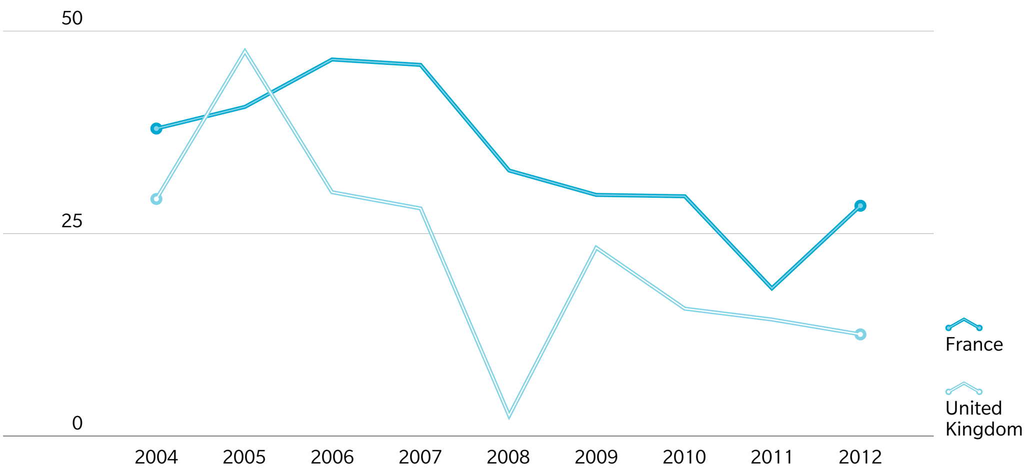
Source: Insurance Europe, Oliver Wyman analysis

1 Source: Insurance Europe, www.insuranceeurope.eu.

Over this period, however, profitability has suffered from lower investment yield and higher costs of guarantees. Creating shareholder value has been difficult. At the end of 2012, profitability in many markets was still below pre-crisis levels.

Exhibit 2: Profitability over time in France and UK (Earnings over liability in bps)[2]

NET EARNINGS ON INSURANCE PROVISIONS, RESERVES AND CAPITAL IN BPS



Source: Insurance Europe, Oliver Wyman analysis

Many insurers have responded by starting to re-examine their in-force books, looking for ways to increase returns. Some have undertaken comprehensive in-force optimisation work with material success. For example, in their 2011 investor presentation, AXA announced a global optimisation programme targeting a €250MM improvement in underlying annual earnings by 2015[3]. Swiss Life, Aviva and Zurich[4] have either launched such optimisation work or made it a key strategic ambition.

These insurers are looking in the right place. Our recent experience across Europe shows that significant potential gains can be achieved from in-force optimisation. In our work with clients, the typical benefits of an optimisation programme are between 7bps and 10 bps of the reserves in additional operating profit. With over €6.2TN of life insurance reserves in 2011, the total potential benefit to European insurers is €4.5BN to €6.5BN. And potentially much more if effective in-force management becomes part of business as usual.

2 Source: for France: FFSA (Net income/average of Technical provisions and own funds before allocation of net income). For UK: FSA Returns (profit for the financial year/average of total liabilities).

3 Source Investor day 2011.

4 Swiss Life: Source BofAML – 2012- Annual Banking & Insurance CEO conference; Aviva: HY 2013 presentation; Zurich: Investor Day December 2013.

2. OPPORTUNITIES TO INCREASE IN-FORCE VALUE

Sources of in-force optimisation can be divided into four broad categories: commercial effectiveness, operational efficiency, financial effectiveness and, in some cases, major structural changes such as spin-off or exit.

Exhibit 3: High-level Oliver Wyman's in-force optimisation framework

COMMERCIAL EFFECTIVENESS	OPERATIONAL EFFICIENCY	FINANCIAL EFFECTIVENESS	SPIN-OFF/ RUN-OFF/EXIT
Leverage existing customer base *(Cross-selling, up-selling notably using customer analytics)*	**Cost optimisation** *(Process optimisation, Near -/Off Shoring, change of service level*	**ALM and Investment strategy** *(Dynamic ALM and Asset allocation, Hedging policy, Liability segmentation*	**Internal separation** *(Carve-out, Run-off)*
Improve retention and customer management *(Persistency and maturity management, orphan management)*	**Cost variabilisation** *(Outsourcing, Multi-skilling)*	**Risk transfer** *(Reinsurance, Securitisation)*	**Transaction** *(Sale, Exit)*
Review and optimisation of contract terms *(Crediting policy, Fee increase, Policy mutation reduction in fees paid to third parties)*	**Claims optimisation** *(Claims process review, Fraud management sourcing)*	**Solvency Capital Requirement/ Risk margin optimisation** *(Model optimisation, "Risk mixer")*	
		Accounting restructuring *(Accounting treatment, Legal entities simplification)*	

As Exhibit 3 shows, insurers can improve the performance of their in-force books in wide variety of ways, all of which should be considered and many included in a co-ordinated effort. Below we discuss six actions that we have found to be especially effective:

- Tackle unprofitable portfolios: Most insurance companies have unprofitable legacy portfolios, often because of high guaranteed rates or contracts based on old mortality tables. Many fail to do anything about these problem portfolios. Some do not even identify them.

  Others, however, have identified the problem and begun to take corrective actions: for example, ensuring that expensive policy-holder options are not extended at maturity or converting these policies to reduce capital requirements. The ability to convert policies depends on local regulation, and is generally limited by an obligation to act with proper care towards the customer. Nevertheless, in most European markets, insurers have been able to mutate some policies.

- Tackle retention issues: All insurers have tackled retention to some extent. However, there remains significant room for improvement. Most could improve customer loyalty using now familiar techniques; they could develop a systematic defence process across all distribution networks; and they could target retention efforts at the customers most likely to lapse. However, while doing so, insurers must remember that not all policies should be kept. As mentioned above, unprofitable policies should be identified and, insofar as possible, modified or let go.
- Improve cross-selling and upselling: Cross-selling between different lines of business is under-exploited. Many insurers still have a siloed organisation and, although they usually aim to cross-sell, they rarely recognise all the opportunities for cross selling between Life and P&C and between different Life lines of business. In a recent in-force assignment, our client increased the value of new business (VNB) by more than 15%. They achieved this by introducing better packaged and marketed products and by a direct and telemarketing push to support sales through the agent distribution network.
- Adopt radical cost reduction strategies: Most insurers have already gone through many waves of cost reduction – simplifying their IT architecture, rationalising their processes or just forcing general expenses down enforcing a cost target. Additional savings from evolutionary measures are now unlikely to exceed 10%. However, significant cost reduction can be achieved by more radical solutions and structural changes. Insurers should review service levels for closed books, aiming to identify areas where they can be reduced. And they should review their value chain to identify activities that can be outsourced. Such changes could lead to a further cost saving of up to 15%.
- Push financial effectiveness further: Most finance departments have already worked on optimising financial management. However, such work is typically done neither frequently enough to achieve all the potential nor with enough creativity. New avenues should be considered, such as investing in new asset classes or changing the reinsurance or securitisation strategy (for example, for longevity risks). Solvency 2 implementation also creates new opportunities. For example, international insurers can significantly reduce their risk margin by implementing an internal reinsurance structure (risk mixer) to optimise geographical diversification.
- Exit non-strategic books: Spin-off, run-off or exit should be considered for non-strategic closed books. So far, the most active market has been the UK, with large consolidators (Resolution, Cinven, Phoenix) playing prominent roles. Portfolios have usually been priced at around 80% of EV. But spin-off should also be considered in continental European markets.

The actions listed within the four categories of exhibit 3 are not mutually exclusive. Initiatives are likely to combine multiple levers and material uplift will often come from a long list of small initiatives rather than from a single large initiative.

3. FIVE GUIDING PRINCIPLES FOR IN-FORCE OPTIMISATION

In-force books are not compendiums of consistent policies. Rather, they contain different products with different cohorts and small but sometimes material differences in profitability. Taking a systematic approach to review them is therefore essential. We have identified 5 guiding principles for extracting the full potential of an in-force book.

- A Marathon with a sprint start: As mentioned, material uplift will often come from a long list of small initiatives undertaken over a long period of time. A long term ambition is necessary. Also to ensure buy-in from the management analysts and investors, the optimisation programme should start with a strong push for "quick wins" and a big medium term prize.
- A systematic, transversal and comprehensive approach: To identify key initiatives and achieve a material uplift, all in-force levers for every cohort must be examined in a systematic way. This requires silos and organisational boundaries to be broken down or, at least, to be crossed in the analysis and resulting initiatives.
- Openness and willingness to challenge the status quo: An in-force perspective is new to many organisations and presents complexities. It often requires current business practices to be reconsidered and involves reviewing many slightly different policies for which internal expertise has sometimes been lost. Insurers must be open to new practices, encourage a re-learning culture and show a willingness to push boundaries.
- Maximise value in the business, not just new business: In the past, new business was the focus. A shift in culture is required. In-force needs to become top of mind, starting from the top management.
- Re-calibrated performance management: The new focus on in-force must be translated into reformed KPIs and compensation schemes. Revised management information should include KPIs on all main in-force levers and overall profitability should become the primary driver of management's bonuses.

4. GETTING STARTED

Tackling in-force optimisation is a complex task. Successful programmes have been structured into four key phases, combining a strong initial push with a longer operationalisation phase progressively embedding in-force optimisation in the company's DNA.

PHASE 1: SET UP

The first phase should lay the foundations for the in-force programme scoping the programme, ensuring organisational alignment and securing support and sponsorship.

PHASE 2: REVIEW IN-FORCE AND IDENTIFICATION OF OPTIMISATION LEVERS

In the second phase, the project team should review the many different portfolios to identify opportunities to improve their performance. To achieve stakeholders' buy-in before moving to implementation, a detailed business case should be built at this stage with a sizing of the opportunities, required resources and budget.

Oliver Wyman has supported many insurers in this phase, including 3 of the 10 largest European Life insurers. On average, opportunities to increase profits by 7-10 bps of the reserves have been identified[5]. Our list of over 100 levers and best practice catalogue of more than 70 case studies have helped speed the work, avoiding wasting time in "reinventing the wheel".

PHASE 3: DETAILED OPERATIONALISATION AND IMPLEMENTATION

Successfully detailing and then implementing the identified opportunities requires:

- Full management buy-in and commitment to ensure the project is pushed as required and that opportunities are not re-considered every time there is a new challenge in the detailing and implementation
- Integrated planning to ensure execution is efficient
- A benefit and cost tracking system to monitor results vs. expectations and, potentially, to trigger remedial actions
- A dedicated team. All too often, the lack of a strong project management office (PMO) means that valuable measures are not implemented.

PHASE 4: EMBEDDING IN-FORCE OPTIMISATION

Value uplift is much greater if insurers make in-force optimisation part of business as usual (BAU). Some insurers have assigned responsibility for this to a member of the executive committee. Others have transformed their in-force project team into a BAU team in charge of a periodic review. All have reviewed their KPIs and management information to make sure in-force and its performance levers are monitored and reported.

5 Including capital benefit value at cost of capital

Despite its significant potential, many European insurers are yet to fully grasp the value that can still be extracted from their in-force contracts and customers. in-force optimisation projects are not easy. They require detailed analysis of legacy contracts to understand where the opportunities lie and which levers can be pulled to generate more value from them. However the experiences of market leaders demonstrate it is possible to do so successfully and with significant benefit.

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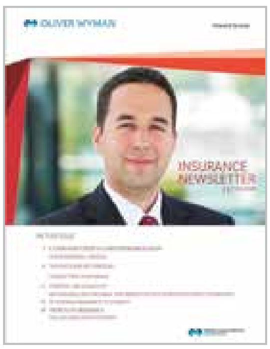

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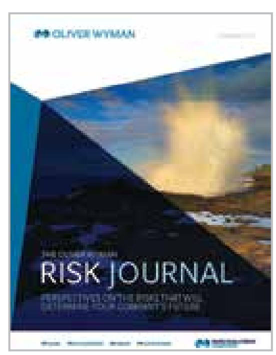

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