OLIVER WYMAN

INSURANCE NEWSLETTER

12TH EDITION

IN THIS ISSUE

MARSH & McLENNAN COMPANIES

INTRODUCTION

I am pleased to introduce the 12th edition of our EMEA Insurance Newsletter.

We are delighted to feature an interview with Toby Strauss, Group Director Insurance, Lloyds Banking Group, about the changes in the UK life market, the role of digital and leadership as the insurance industry undergoes this important period of change.

The articles in this edition demonstrate the breadth and depth of our work in the insurance sector. Our extensive research in the UK life industry has delved into the economic impact of the sector following UK's Budget announcement. Another ongoing theme for many insurers is on optimizing the in-force book in a mature life business. Insurance markets are changing radically; our most recent article is on the impact of the risks arising from digital. Insurers need to think hard about the changes brought on by the digital revolution, a topic which I'm sure will be debated over the months to come for the industry. We also present our perspectives on enhancing the risk culture in financial services, indeed not a "soft" topic, but very tangible given that 60% of all operational risk incidents are related to people and cultural issues.

Finally, for those who haven't heard, I will be embarking on a new journey to lead Oliver Wyman´s Asia-Pacific business (although insurance will remain my area of expertise) and would like to thank all our clients for the trust they've instilled in us. I am delighted to introduce to you Erik Stattin as our new Head of EMEA Insurance practice, who combines many years of consulting and insurance industry experience.

Please reach out to us anytime if you would like to explore any of the presented topics further. You can also download previous editions of our insurance Executive Conversations on:

http://www.oliverwyman.com/executive-conversations.html

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A CONVERSATION WITH

TOBY STRAUSS

Group Director, Insurance,
Lloyds Banking Group

Interview conducted by **Sean McGuire**, Partner, Insurance, Oliver Wyman

Oliver Wyman: *Toby, thank you for taking the time to speak with us today. There has been a big shakeup in the UK insurance industry due to various changes over the last 12-18 months. It would be good to understand how these changes have impacted Lloyds Banking Group's (LBG) insurance business and how LBG is responding.*

TOBY STRAUSS: There is an increasing focus on margin and seeing better value for customers - whether they are legacy or new. The impending legacy review will inevitably lead to pressure on these margins - at least for some insurance players. Also, changes in annuitisation, which open the door to new entrants as you won't need to be an insurance company in order to be able to be a big player in retirement. However, you're probably still going to need an insurance company in the mix to provide the annuities. The balance of power is shifting. There is a greater need for insurers to reach out to the customers, but in a very different form, especially with the growth of digitalisation.

"The balance of power is shifting. There is a greater need for insurers to reach out to the customers, but in a very different form, especially with the growth of digitalisation."

Oliver Wyman: *How have customer behaviours changed over time?*

TOBY STRAUSS: Customers are looking for increased value for money. They're more informed and the yields are down. Inevitably there's a pressure on cost, a lot of what has happened in the UK has been driven by the regulators. However, I would argue that it would have happened anyway, driven by those same fundamentals, but over a longer period of time. Those fundamentals may also be true in Europe where the shifting is happening at a slower pace. Many customers may have a trust in their insurers and banks today, but it's inevitable that customers will use the internet to do more research, increasing their financial knowledge.

Oliver Wyman: *Digital is a pretty hot topic at the moment. Where is the LBG insurance business positioned in terms of digital?*

TOBY STRAUSS: Digital for insurers is an interesting challenge. Quite a lot of general insurance businesses have spent a lot of money on servicing technology and actually it's not being used very much by the customers. There are lots of software technology companies with solutions looking for a problem. I think the underlying problem is getting the customer to engage. The big advantage for us relative to standalone insurers is that we have internet banking customers and we have a rapidly increasing usage of that. The challenge for us is to present our products in a seamless way through the online environment for the customer, so that it becomes a value add for them.

> *"The big advantage for us relative to standalone insurers is that we have internet banking customers and we have a rapidly increasing usage of that."*

Oliver Wyman: *There's an increasing focus on conduct risk, particularly in the UK, with the formation of the Financial Conduct Authority (FCA). How has the LBG insurance business shifted to address this new conduct environment?*

TOBY STRAUSS: It is evolving. The FCA has only been formalised for a relatively short period of time and they're still finding their feet. There's also a very strong political dimension to it which is still being played out. We're trying to be at the forefront and so conducted an independent review of our insurance businesses approach to managing risk more broadly. One piece of feedback from this is that we are much more

customer-centric than many of our peers. All in all we're making good progress, but we still have a long way to go in our journey. We have developed and launched various products over many years, all being very different and challenging to introduce and operate in a seamless way we have. We have a relatively disengaged customer base that tends to engage at the point when they retire. This is very different to the fashion industry, for example, where the topic is a high priority in the minds of customers. We need to focus upon how we make insurance a higher priority in the minds of our customers. The right action is to make it very easy for the customers to engage when they are ready to and how they want to, ensuring that they know where to go for advice and guidance.

Oliver Wyman: *What are your key priorities for LBG's insurance business over the next 2 – 3 years?*

Toby Strauss: It's responding to the changes we've been talking about. The change for the UK's insurance industry following the 2014 Budget announcement has created a lot of opportunity and the need to provide customers with a compelling and engaging experience, not only at retirement but post-retirement. As an industry, we're entering into a very different world where people will have assets with us, but will withdraw these over time. They'll need investment strategies for those assets, catering for changes in their own circumstances. We will shift from customers buying annuities at retirement to one of a longer-term engagement and that's a big opportunity. I think responding to the change and maximising the opportunities is one of the biggest focus areas for us. It's about staying confident in a market that's becoming increasingly competitive. Our key advantages are our direct internet banking, building on our existing customer relationships, and doing a good job for our customers in this evolving environment. To have more flexible modular products, but still keep it simple. It's how you stand out in a world where there are a number of players trying to commoditise.

"Responding to the change and maximising the opportunities is one of the biggest focus areas for us. It's about staying confident in a market that's becoming increasingly competitive."

Oliver Wyman: *The insurance industry is becoming more important in terms of the role it plays in society, especially as the banks retrench from investment in infrastructure and so forth. What role do you see LBG's insurance business playing in the broader society over the coming years?*

Toby Strauss: We're in a world where people are living longer and will have to put their own provision in place to care for themselves as the state can no longer afford to provide this funding. A lot of organisations see this as an opportunity. Not just the insurers, but also the asset managers, banks and investors. There are some unique things an insurance business can do in terms of managing long-term risk, and that has to be at the heart of what we do. We have already made good progress in this area: for example, substantial investments in social housing, infrastructure and loans to educational institutions.

> *"Customers will be more demanding, so the need for straight-through-processing is important."*

Oliver Wyman: *What is your outlook for the UK's insurance industry over the next 5 – 10 years?*

Toby Strauss: There will continue to be pressure on margins, creating a greater need to become more efficient. Customers will be more demanding, so the need for straight-through-processing is important. We collectively have to become much more customer orientated by worrying less about products with clever bells and whistles, and more about delivering the outcomes that customers want. It's about how we communicate and create products and solutions that they can engage with and meet their needs. The different parts of the broad spectrum of what insurers do will go in very different directions. For example, I think a significant number of customers will still want support in purchasing, but there will also be many customers who go and buy their own protection online without any assistance.

Oliver Wyman: *You mentioned change; another big change is Solvency II. How big an impact do you think Solvency II will have on the day-to-day running of your business and decision making?*

Toby Strauss: In the UK, certainly for the larger players, it is already happening. The Prudential Regulation Authority (PRA) is very focused on transition. To a great extent, we're through a lot of it already, in that sense it's been a transition over the last two or three years and we're 80% of the way through. I don't think looking forward it will make that much difference to us, because we are already calculating all those numbers on a Solvency II basis. Obviously there is still more detail to work through, for example, on which assets will be eligible for the Matching Adjustment. How this finally lands will affect the industry's ability and appetite to invest in different asset classes.

Oliver Wyman: *How would you describe your leadership style do you think it has evolved much over the last few years?*

Toby Strauss: I'm very content focused. I like to understand what the right answer is, rather than managing the process. I do try and give my team space for them to do their job and I think that having a bit of fun and humour around is important too. With large organisations, the key is what to focus on. Thinking hard about how you make change happen and how you land it well, both in my area, and our broader relationship with our parent (LBG Group) is something I personally have spent quite a bit of time thinking about, and adapting from the self-contained business environment that I had come from.

Oliver Wyman: *Where do you get your energy from?*

Toby Strauss: I talk to people out in the market and to colleagues who work at the front-end. You always learn something when you take the time to go out and talk to new people. It gives you a real and tangible understanding of the market. Also getting out and about talking to other key market players, such as, aggregators, employee benefit consultants, the individual IFA firms: you have to talk to quite a few of them because they're quite a heterogeneous group. Only talking to one or two won't get you anywhere.

Oliver Wyman: *How do you keep motivated, what do you do in your downtime?*

Toby Strauss: Within work I'm very motivated by the scale of what we can do for our customers. One of the huge benefits and privileges of doing this job versus running a mid-sized business is the scale of impact you can have on getting customers to save in their retirement. But it can be very intense too, so I do a lot of sports outside of work, such as cycling and sailing. I'm also a trustee for Macmillan Cancer Support; I've been a trustee for a year and a half. It's been really interesting, I spent some time at Frimley Park Hospital and met with the patients there and the Macmillan nurses, and that's where you really see the difference. It's something that's very personal to me given both my parents suffered from cancer, and I've wanted to be involved for some time, so I'm delighted to have had the opportunity to invest my time in this worthy cause.

Oliver Wyman: *Thank you Toby for taking the time to speak with us.*

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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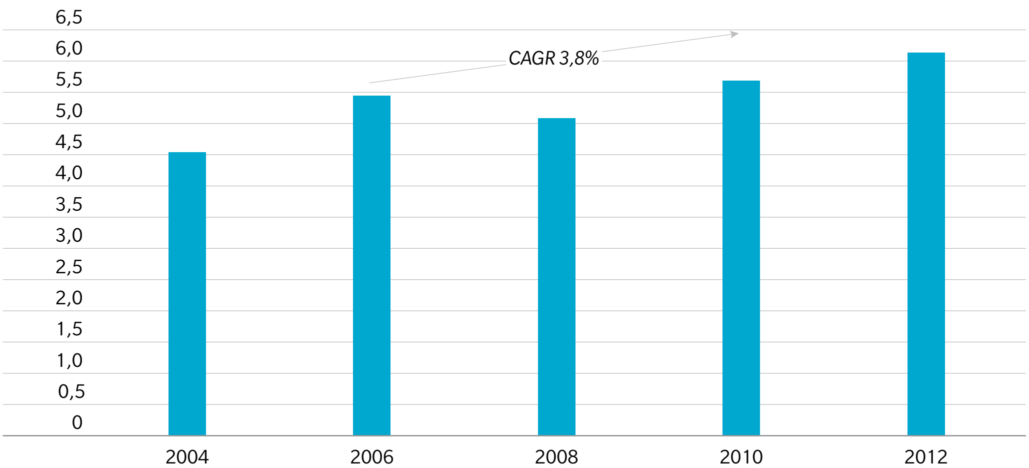
Life insurance is a mature business and profitability in many markets is still below pre-crisis level. Making the most of the in-force book can unlock substantial value: 7-10 bps of the reserves in additional operating profit and, potentially, much more if effective in-force management becomes part of 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

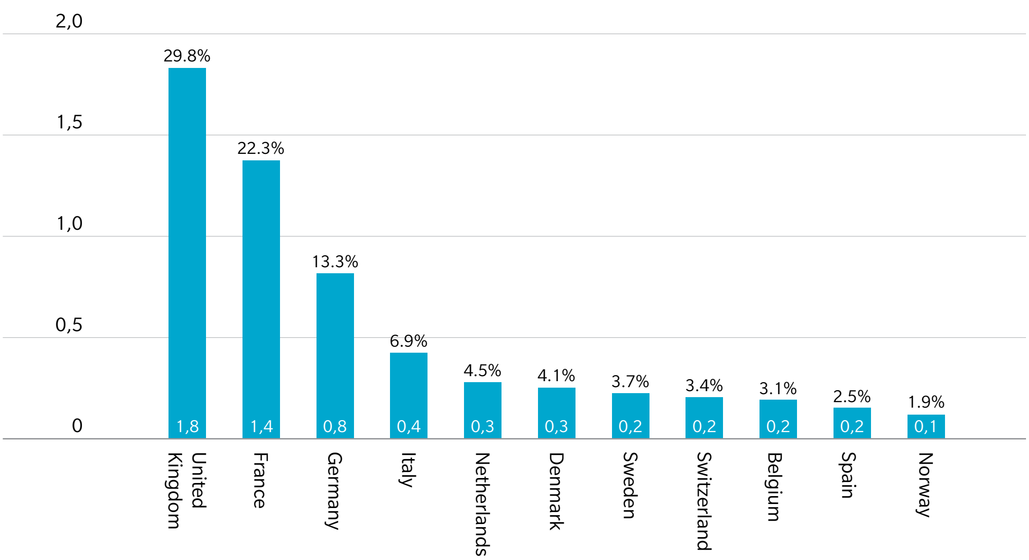
From 2004 to 2012, Life in-force in Europe has grown by 35%[1] despite a 10% drop in 2008 caused by the financial crisis. At the end of 2012, Life in-force gross provisions were €6.2TN, with UK, France and Germany accounting for two thirds of this volume. On average 36% of the in-force is unit-linked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

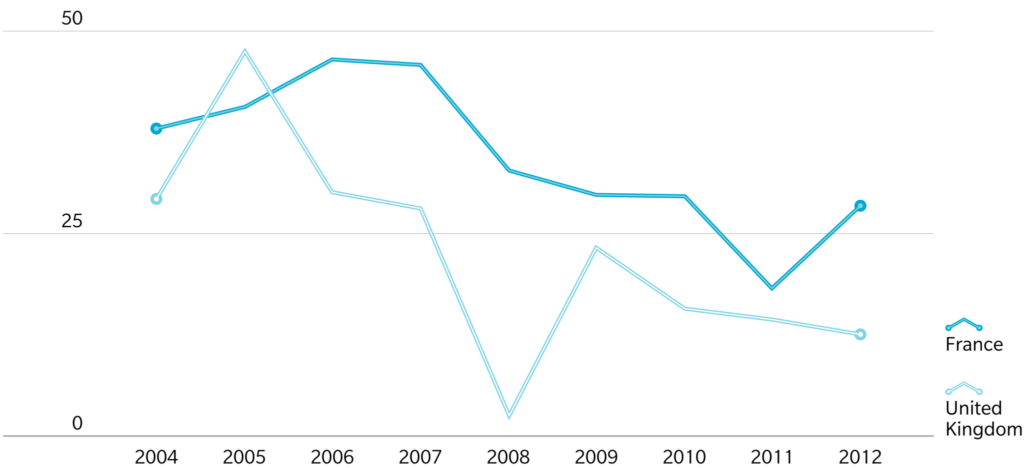
Source: Insurance Europe, Oliver Wyman analysis

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

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.

THE REAL RISK FOR PROPERTY AND CASUALTY INSURERS

IRRELEVANCE IN THE NEW DIGITAL WORLD

ARTHUR WHITE
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Cyber risk, telematics, "digitalization," and related buzzwords dominate discussions about the future of property and casualty insurance. These are important topics, but they are only the visible manifestation of a deeper and more fundamental threat: namely, that in this new world, today's property and casualty insurers are becoming irrelevant to their customers.

This threat has been created by three profound changes in the insurance market.

THE TRIPLE THREAT

The first big change is around how *customers* behave – specifically, how they choose to interact with the people, objects, and companies in their lives. This is not merely a question of buying online. Increasingly, many of customers' most valued assets are virtual (their photos, their music); their business and social interactions are mediated digitally – and their physical possessions and surroundings are increasingly connected. This is a world where people's hopes, fears, and risks (and hence their insurance needs) are changing fundamentally.

The second transformational change concerns *information*. Vast floods of information about customers and their true behavior are becoming available. For example, a simple smartphone app can reveal more about how a customer really drives than any motor insurer has ever before known. It will be absolutely vital for insurers to work out how to gain access to these gushers of data, and how to convert them into insight.

The third change is in *competition*. Insurers are now coming face to face with new types of competitors with stronger brands, better customer relationships, more analytical firepower, and lower costs than the traditional insurer. These competitors are not only the well-known "big beasts" of the digital era, namely the likes of Google, Apple, and Facebook, but also retailers, utility providers, home servicers, and auto manufacturers. For example, the "my first Audi" concept in Germany bundles insurance into a single, low, monthly car rental cost.

DEVELOPING A COMPETITIVE ADVANTAGE

These developments mean that many of the competitive advantages that insurers have relied on in the past – brand, physical distribution networks, and scale – are losing their value. (See Exhibit 1.) At the same time, new business models are emerging that look very different from those followed by a traditional insurer.

There is, of course, no single recipe for success. But the winners to date seem to share a number of characteristics. They rely heavily on analytics and actively seek out new types of customer data and insight. They use this data to make decisions rapidly, and react quickly to changes in the competitive landscape –for example,updating prices to customers daily, rather than monthly, and updating underlying technical models monthly, not yearly.

They have an entrepreneurial or "trading" mentality, founded on a "test and learn" culture of finding out what works and what doesn't. This is true not only in setting prices and designing the digital customer journey, but also in areas such as lead generation, retention management, and outbound communications.

EXHIBIT 1: THE CHANGING SOURCES OF STRATEGIC CONTROL ADVANTAGE IN INSURANCE

WHAT DRIVES STRATEGIC CONTROL?		WHY DO INSURERS NO LONGER FIND IT EASY?	
OWNING A CRITICAL ASSET		Extensive branch and agent/broker networks...	...start looking like expensive liabilities if customers want to interact digitally.
A BETTER PRODUCT OR LOWER COST		Economies of scale from being the biggest insurer in the market...	...are undermined when new entrants have lower costs and better loss ratios.
BETTER ACCESS TO CUSTOMERS		Even the best-known insurance brands...	...turn out to be rather weak consumer brands.
BETTER KNOWLEDGE AND INSIGHT		Having the most policies in your portfolio...	...is no longer enough when new, far more insightful sources of data are available.
REACH AND NETWORK EFFECTS		Economies of scale and scope in operating claims networks...	...are undervalued by the end customer.

Source: Oliver Wyman analysis

They also have low operating costs, driven by a different approach to operations. They give primacy to digital interactions, customer self-service, automation, e-trading in underwriting (even in small commercial), and digital claims management.

The most successful new models have been built anew, rather than by cutting back an existing business. The best examples have achieved the operational holy grail of better customer outcomes, more satisfied staff, much lower operating cost, and, better loss-ratio outcomes.

MAKING IT HAPPEN

These new types of business models are a long way away from where most insurers are today. Even if they accept the need for change, many large insurers will find it extraordinarily difficult to achieve it. They must struggle against legacy IT systems, resistance to change among staff, and skepticism created by the failure of previous cost-cutting initiatives.

The skills needed may require new talent, often from outside the insurance industry – which poses the challenge of how to attract and retain the type of commercially aware, entrepreneurial, digital-savvy employees who have not in the past seen insurance as their first choice.

Some large insurers have addressed this by taking a "skunk works" approach, piloting a new business model outside the constraints of the existing setup. This approach can pay dividends, not least by demonstrating what can be possible if today's constraints are relaxed. But it does not answer the question of how to transform the wider organization.

There is, of course, no easy answer to this question. Transforming large insurance firms will take tremendous effort from their management and leaders. Creating a sense of urgency and direction is the first step to motivating that effort. To do so, and to survive commercially while change is underway, we recommend the following six actions:

1. **Carry out an unsentimental analysis of the status quo.** Examine the drivers of change in the market and evaluate where your company will be allowed to make a profit five or 10 years from now.

2. **Think big when making strategic plans.** Staying competitive requires transforming a company's operations, culture, and talent model toward becoming genuinely agile, entrepreneurial, and low-cost.

3. **Don't be paralyzed by the scale of change.** Avoid becoming distracted by the need to "run fast to stand still." Start with some small steps that deliver significant wins and demonstrate the art of the possible early on.

4. **Position yourself to capture value in a world with vastly more data**. Get to the forefront of analytical techniques and potential uses of new data by taking advantage of new approaches not just to analytics and IT infrastructure, but also by setting up the right organizational structures and hiring new and different talent. Avoid being out-innovated by startups or technology companies.

5. **Get fit for change to ease the transition.** Protect the back of book and actively look to take cost out. In our experience, cost reductions of 30 to 40 percent are achievable if the company takes a "blank page" view of what is now possible in a digital world.

6. **Make defensive plays to avoid being squeezed out by new competitors**. Find propositions that cannot easily be replicated by new entrants, such as bundling multiple products to offer unbeatable value. Insurers should also consider entering into strategic partnerships with potential competitors before the balance of power shifts too far.

CONCLUSION

Insurance markets are changing radically, and so are the sources of competitive advantage within it. Insurers need to think hard about the changes brought on by the digital revolution, or they risk becoming irrelevant to their customers.

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Financial Services

POINT OF VIEW

GETTING TO THE HEART OF RISK CULTURE WITHIN FINANCIAL SERVICES

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"Getting back on the right path ... requires investors and financial leaders taking values as seriously as valuation, culture as seriously as capital"

*(CHRISTINE LAGARDE, MANAGING DIRECTOR - INTERNATIONAL MONETARY FUND.
SOURCE: IMF WEBSITE, SPEECH ON ECONOMIC INCLUSION AND FINANCIAL INTEGRITY PREPARED FOR THE INCLUSIVE CAPITALISM INITIATIVE CONFERENCE, 27 MAY 2014)*

1. INTRODUCTION

1.1. THE DOCTOR'S PARABLE

A patient is unwell and visits the doctor. The patient is suffering from unpleasant symptoms, hence is impatient to get relief.

The inexperienced doctor, driven by the patient's impatience, provides a treatment that lessens the symptoms. This treatment does not address the underlying cause because this is not clear to either the patient or the doctor. The patient is happy with the outcome, as they have their prescription and a 'quick fix' resolution to their symptoms. But the patient's happiness is short-lived. The long-term, underlying problem remains, and will re-emerge in time.

By contrast, the more experienced doctor recognises the need to understand the underlying cause. They recognise that symptoms are only a part of the picture and can often be ambiguous, even misleading. This doctor uses their skill and experience to select from a wide range of possible tests and techniques to test hypotheses. They pursue the right diagnosis which uncovers the underlying cause. This may take a little more time than the inexperienced doctor, and can require additional loops as certain causes are ruled out and new tests are conducted. Once the underlying cause is determined beyond reasonable doubt, the experienced doctor prescribes an effective course of treatment – a treatment that eases both the symptoms and tackles the underlying issue. With good communication, the patient does not become frustrated at the longer diagnosis phase as they grow to understand the underlying causes of their illness and the importance of the right treatment.

1.2. THE PARALLELS WITH CHANGING RISK CULTURE

In the context of organisations, corporations and institutions, poorly diagnosed or designed risk culture initiatives are akin to the inexperience doctor's approach. These programmes use superficial analysis of the symptoms and give in to demands for a quick fix approach. The result tends to be a generic action plan, which does not address or even understand the underlying cause of the risk culture issues. In concrete terms, these programmes often use only benchmarking tools for diagnosis. In taking action they focus on structural adjustments and 'sheep dip' programmes (typically communication and training sessions) through which employees are presented with new structural approaches and values. We do not believe that these programmes are effective. They do not materially shift risk culture as they do not tackle the underlying drivers – most notably behaviour. These programmes deliver short-term actions, but really little happens when it comes to shifting the organisation's underlying behavioural norms.

By contrast, more effective risk culture programmes use the approach adopted by the more experienced doctor who takes the time to understand the issues before creating the right risk culture for an organisation.

In this point of view, we explore the current state of the Financial Services risk culture and lay out more clearly the behavioural aspects of change required, including how Financial Services organisations can go about achieving these changes.

2. DEFINING RISK CULTURE

2.1. THE STATE OF RISK CULTURE IN FINANCIAL SERVICES

What is risk culture? A practical definition is that it is how individuals and teams in an organisation behave in relation to risk issues – both the day-to-day and business critical risks. Risk culture is inherently a human issue.

A mature risk culture is not a more risk averse culture. Informed risk taking is an important element for Financial Services organisations and the financial system as a whole. By contrast, a mature risk culture shapes consistent behaviours in an organisation's people around awareness, understanding, risk appetite, position-taking, and management of the risks themselves.

Risk culture is a vital part of the whole risk system, because even small, isolated pockets of poor risk culture can thwart efforts to improve management and control of risk within organisations. Without a constructive risk culture, risk management becomes heavy with processes and controls, and often in conflict with the business strategy. Even if structural risk management is good, an unsupportive risk culture is distracting, expensive and exhausting for all those involved.

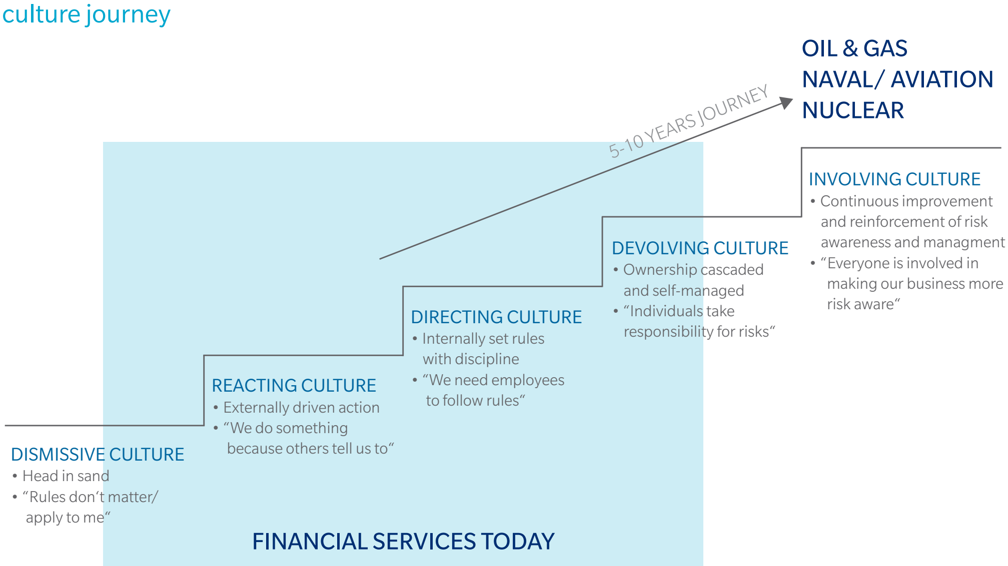
On the other hand, with a constructive risk culture, risk management efforts are supported more naturally. Responsibility for risk management becomes easier to distribute across the organisation and eventually a part of the way we work everyday. Overall, the investment in risk management becomes more effective.

Across Financial Services the state of risk culture is under scrutiny, elevating it on the agenda of the Boards of Financial Institutions who are putting significant pressure on senior management to change the way their organisations behave on risk issues.

We believe this focus is justified. Shortly after the global financial crisis we interviewed 27 companies from the Financial Services sector and compared their performance and procedures with companies in asset intensive industries such as Oil & Gas and Mining[1]. A lack of an adequate risk culture has been a significant factor in many of the recent failures in Financial Services. Across the whole sector we saw that over 60% of operational risk incidents were related to people and cultural issues, but less than 10% of mitigation initiatives relate to behaviours – a balance that needs to be rectified.

Our analysis indicates that Financial Services organisation's risk cultures are between 5 to 10 years behind similar sized organisations within asset intensive industries.

Exhibit 1: The risk culture maturity stairway – Financial Services 5 to 10 years risk culture journey



[1] **Source:** Corven: Banking on culture to manage risk (October 2012)

2.2. BUT TOO MANY INSTITUTIONS ARE ON THE WRONG PATH

We see confusion within many Boards and management teams around risk culture: What is it? What does our risk culture really look like? Can I measure it? Does it differ across the organisation? What should our risk culture be? How does it align to our business objectives? How do we change it?

Our experience shows us that too many organisations view risk culture as either something structural to fix (for example, adjusting organisation processes and compensation systems), or something that can be addressed through communication and training (for example, a programme of posters, videos, new values and training). Whilst these support the development of aspects of a risk culture, they fail to recognise that risk culture is a human issue and changing it requires both human solutions and structural changes, which in unison adjust behaviours effectively over time.

Many organisations underestimate the complex nature and relationships that exist around their risk culture, and do not appreciate that the current risk culture is resistant to change. Our behaviours are complex, varied and habitual, and therefore risk culture is both difficult to diagnose, and self-reinforcing. The science of unconscious biases helps make the case as to why this is so. Our behaviour is influenced by those that are like us (belonging); others in the group (herding); authority (trusting); and data that supports our current views or the established views of our organisation (confirming). These are all natural tendencies, and are all very human. They affect all of us, often unconsciously, and reinforce the current behavioural norms.

For Financial Services organisations that are attempting to move to a more mature risk culture, our experience shows that the right path is one that focuses on understanding and then changing behaviours from within, rather than structural changes and 'sheep dip' programmes. We would stress the importance of the behaviours of an organisation's leaders from CEO to individual team leaders. Getting the right behaviours sustained by these leaders is critical to ensuring sustained change across the organisation.

3. DIAGNOSIS – HOW TO ANALYSE RISK CULTURE

Before deciding what needs to be done, organisations must first understand how the current risk culture is manifested in the behaviours of their people, what is reinforcing the current risk culture, and how they will know when the right risk culture has been created. Much as a doctor would, there are an array of assessments and tools across a number of themes, to comprehensively diagnose the situation.

Standard tools and techniques include:

DIAGNOSTIC AREA	TOOLS AND TESTS (TYPICAL EXAMPLES)	OUTPUT
Behavioural Analytics	☑ Leaders behavioural assessment ☑ Review of existing staff engagement surveys and 360 feedback ☑ Risk culture survey for a cross-section of the organisation ☑ Analysis of behaviours that led to past failures and understanding the drivers ☑ Structured observation of critical meetings and operations ☑ Mapping of the leaders' formal and informal impact – mapping both degree of impact and span of influence	• Shows the status quo of how current risk culture manifests in the organisation • Demonstrates how it differs across the organisation and the different groupings • Provides input to enable prioritisation and a benchmark of the current risk culture to track against • Provides detail on how group dynamics operate and where biases may be helping and hindering change
Structural Assessment	☑ Review of: • *Governance/decision forums and authorities* • *Reward and compensation structures/enforcement/ penalties* • *Reporting and monitoring content and impact* • *Appraisal and feedback structures* • *Staff training and development* • *Promotions, hiring and on-boarding* • *Internal and external communication* ☑ Past failure 'structures' analysis – tracing back symptoms through the lens of the current operating model (structure, process, procedures, policies, roles, information, etc.) ☑ Focus group sessions with small groups of mid-level staff to help refine the insights gained in both the Behavioural Analytics and Structural Assessment	• Shows the ecosystem that supports the existing organisation and risk culture • Highlights imbalances between behaviours and structures • Provides input on important structural elements to adjust and nurture new behavioural norms improving the risk culture and performance • Highlights real life case studies and stories, enabling senior management to see where reality may not align with their perceptions
Future State Assessment	☑ Articulation of desired future risk culture alongside the business strategy and vision ☑ Test of risk culture measurability	• Shows the end goal for risk culture and definition of a healthy risk culture (or not) for the organisation to measure and monitor progress • Helps leaders debate the challenging issues around how risk culture sits alongside business strategy (for example short-term results vs long-term business risks) • Starts the process of mind-set change within leaders in terms of engaging them with the end vision • Identifies measures and metrics to monitor progress

We are not suggesting that all the tools in each part of the toolbox should be used in all circumstances. However, our experience shows that elements from all three diagnostic areas are important to include. Without this, it is highly likely that the interventions will not be optimal – in fact, poorly coordinated actions may contradict or undermine each other.

One clear observation we have made is that too few organisations use behavioural analytics tools in diagnosing their current risk culture. These are vital as the underlying behaviours are the demonstration of culture in action. We recommend focusing on behaviours rather than focusing a lot of effort on perceptions of values, which are harder to change and less tangible.

The added benefit of this diagnostic approach is that leaders will gain a much clearer view of the status quo, the drivers and the vision for the future – these in themselves make driving change more effective.

CASE STUDY 1*

BEHAVIOURAL ANALYTICS IN DIAGNOSTIC PHASE THAT DRIVE CHANGE AT AN INDIVIDUAL AND TEAM LEVEL

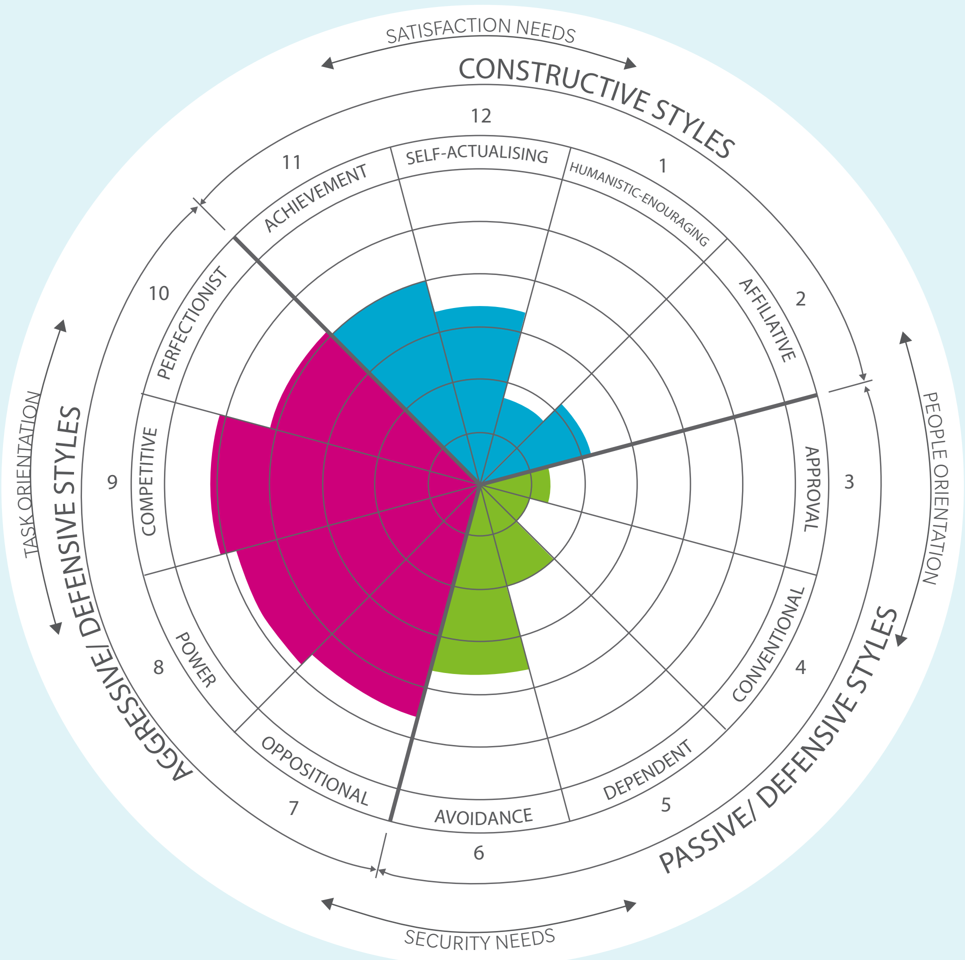
In this programme we supported an organisation with 60,000 employees to identify and change elements of their culture via behavioural interventions.

Through the diagnostic phase we identified the desired behaviours, as well as, the leaders and individuals that would drive the change in behaviour.

Here we take a detailed look at one of the many individuals in the programme and their behavioural impact.

A very successful individual that leads the Operations Division and was known as 'The Silver Back' – he trusted his gut and in the majority of cases was right. He struggled to fully articulate his ideas and believed he was surrounded by idiots as no-one contributed to discussions. He found himself often yelling at people to get things done, some saw him as a bit of a bully, but he did deliver results. In this case we used the Human Synergystics *Life Styles Inventory*™ (LSI) to diagnose and map his behaviours (see exhibit 2).

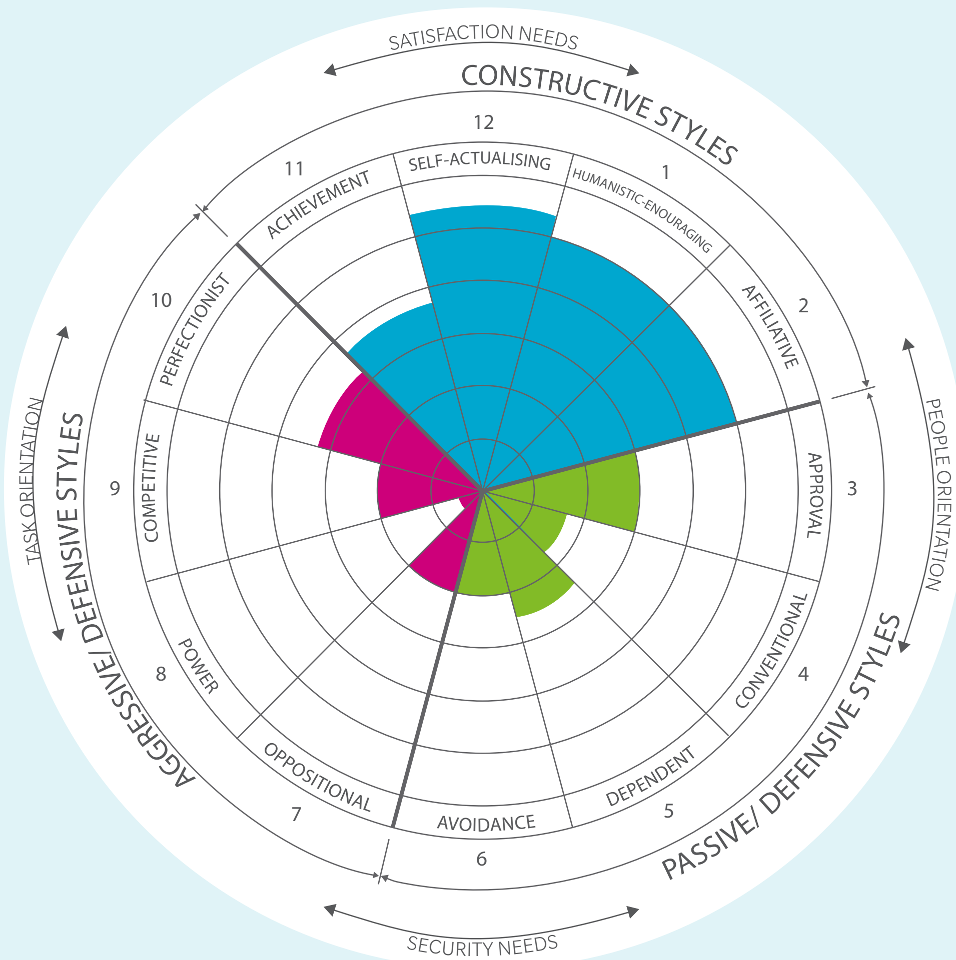
Exhibit 2: Before©



This analysis showed the high levels of aggressive behaviours and lack of development both of himself and others in his team. This led to knock on behaviours and set some of the cultural tone in the division. It also became clear that many of his behaviours were not consistent with the agreed future state behaviours.

This diagnosis tool provided a starting point for a series of behavioural changes over a period of 18 months. Working together with him and his team he dramatically changed his behavioural styles with a resulting impact on the culture in the division. He listens, seeks peoples' views, considers the impact he might have in meetings before speaking, and is able to use data to support his gut feelings. One of the team members involved at the start of the programme went on extended leave. On their return they were amazed at the change. Exhibit 3 shows the final profile for this leader and the behavioural shift achieved.

Exhibit 3: After©



4. TREATMENT – HOW TO CHANGE RISK CULTURE

Too many risk culture change programmes focus primarily on making structural adjustments in the organisation. They change reporting lines, compensation, year-end review forms, policies and other elements of the ecosystem. They then typically roll out a 'sheep dip' programme. The rationale is that these actions are sufficient to kick-start change in an organisation's risk culture. We disagree. In our experience these programmes have a temporary benefit. In many cases, they do little more than provide a short-term illusion of action and in the worst case deliver cultural change fatigue. Changes are embedded on paper only, not in behaviours.

We recommend leading with behavioural interventions to embed a more mature risk culture, supported by a coordinated programme of structural changes. We also believe that a sustained effort is required to transition these into behavioural change.

4.1. A SHORT ANATOMY OF BEHAVIOURAL INTERVENTIONS

An effective behavioural change approach uses a programme of planned waves. Each wave is typically 90 days, creates changes in behaviours and achieves the associated business impact.

This approach ensures that the impact of the first wave of change informs what needs to be amplified or adjusted in the next wave. For those leading the change in risk culture, we believe that it is important to recognise that behavioural change interventions are not linear like many structural changes. Instead it is a process of interlinked behavioural adjustments across many groups and individuals. Although each wave of interventions will, and should, have a measurable impact upon the culture if done correctly, this change will sometimes move in an unpredicted manner. These learning loops and a commitment to running multiple waves are therefore important.

The behavioural interventions should be focused on specific target groups and address defined behaviours. They will be based upon the data and insights gained in the diagnostic phase, and be tailored to each individual or group. The interventions are typically delivered via a number of forms, including:

- Working sessions and workshops
- Visits and experiences
- Support and coaching
- Pilots
- Peer feedback and action based reviews
- Consistent communications

These actions need to be carefully designed as the detail is important if they are to be effective. In designing these, we recommend drawing from techniques that rely upon insights around how professionals learn new behaviours and establish new neural networks. We have found that the most effective tools apply some of the latest thinking from research in neural science, neuro-linguistic programming techniques and behavioural change. Many of these activities nudge behaviours by influencing them at both a conscious level (where many programmes focus) and a subconscious level (where most behavioural change occurs).

Many people believe that such change should always start at the top, based upon the assumption that the behaviour of the hierarchy mirrors perfectly the impact of a leader's behaviour. Our experience shows that the impact of leaders' behaviours is rarely an exact mirror. A critical part of our assessment identifies which leaders have a bigger impact on the current organisation and we recommend that they are included in the first wave.

Over time, as leaders demonstrate new behaviours which are sustained, this does have a positive ripple affect across the business with others then emulating behaviours and modifying them to suit their working environment. To ensure there is a sufficient level of consistency across the organisation, a subsequent wave of change would typically be used to shape how teams and individuals emulate their leaders.

In addition to role modelling behaviours, both formal and informal communication supports the change, and helps use authority bias and group dynamics to precipitate changes in behavioural habits. As well as the normal corporate change communications, targeted and at times provocative communications can be used to help nudge people and get them thinking about the change in their day-to-day working environment.

CASE STUDY 2

A TYPICAL BEHAVIOURAL INTERVENTION PROGRAMME

The Board of a global Financial Services organisation asked us to support the change of their culture to one with greater transparency, support and challenge. This programme was developed for the top three layers of leadership to help develop and support them in shifting the organisation.

We implemented three 90-day waves of change; each focused on a distinct aspect of the desired cultural change:

- Wave I: Focused on the behaviours required at an individual level to become a more resilient leader who is better able to deal with change and risk, including areas such as building self-belief, managing contentious situations, trusted advisor conversations, and performing under pressure
- Wave II: Focused on inter and intra team dynamics and how they could improve the level of transparency, trust and collaboration across the holding company and its divisions
- Wave III: Focused on the organisational and structural changes needed to support the new culture and way of working, creating a highly resilient organisation with changes in learning and development, governance and staffing

The impact of the change was demonstrated in the re-running of the behavioural analytics used in the initial diagnostics – 80% of the leaders were much closer to the ideal behavioural pattern. Feedback within the organisation was very positive with evidence of an accelerated change.

4.2. STRUCTURAL CHANGES TO REBUILD THE ECOSYSTEM

In parallel with the behavioural changes, work must be undertaken to ensure that the structural elements of the organisation (such as performance management and incentive frameworks, promotion processes, policies, controls, and rules and guidelines) are aligned with the new risk culture. The good work being done to gradually change behaviours will be quickly undermined if compensation frameworks still incentivise the wrong behaviours, or if risk policies are insufficiently clear or comprehensive. The structural drivers that are often adjusted and improved include:

- **Articulation and communication of mission, strategy, values and risk appetite.** Communications should be clear and consistent, so that staff understand how the organisation's goals and values apply to them and help translate these into changes in their daily actions
- **Organisational structure and governance.** The formal structures people work within (for example, reporting lines, committees, role descriptions, decision rights, delegated authority, key decision processes, etc.) need to support the desired culture
- **Policies, training, processes, tools and data.** Policies and procedures should be clear, comprehensive and consistent, communicated and accessible to relevant staff, so that no one can claim that they are not aware of the rules. Processes with clear roles, responsibilities and deadlines reduce conflicts and frustrations. Robust tools and data are required to enable the rapid identification and escalation of issues
- **Performance management, targets, incentives and enforcement.** Aligning personal, team and group targets and incentives with cultural values, rewards the desired behaviour. Setting, communicating and enforcing meaningful and proportionate penalties for risk or compliance breaches discourages bad behaviours. However, ambiguous and an overly long list of targets can be counterproductive
- **Employee hiring, direction and development.** A high performance and risk mindful culture helps attract, grow and retain talented staff, reinforcing business success and risk awareness. Cultural messages and priorities therefore need to be embedded in key HR processes such as recruitment, on-boarding, training, succession planning, and promotions
- **Structural controls.** Even institutions with a very robust risk culture cannot dispense with structural risk controls entirely. Accidents will happen, human error will occur, honest mistakes will be made and the occasional 'bad egg' employee will pop up now and then. Therefore, a robust structural control framework (limits, policies, restrictions, rules, monitoring, and controls) goes hand-in-hand with a strong risk culture to ensure risk-taking remains within appetite

This in itself can amount to a material effort, requiring careful review of the organisation's policies, processes and frameworks to identify and address inconsistencies. This can be especially challenging when sensitive topics such as compensation are involved.

These changes play a critical supporting role. They ensure that structures are created that are consistent with and will reinforce, and not undermine, the new risk culture over a sustained period of time.

4.3. CHECK-UPS – HOW TO KNOW WE ARE MAKING PROGRESS

Although organisations may agree on the desired end state with respect to the risk culture, the starting points and duration of the journey varies from under a year to five years. Changing risk culture takes time, effort and skill over a sustained period, to rewire behaviours that have been built and reinforced over many years.

Hence, when undertaking a critical programme which touches the entire organisation, it is vital that monitoring is robust. Progress needs to be measurable with achievements recorded each quarter.

Fortunately, the behavioural analytics diagnostic tools provide suitable options for measuring progress against the risk culture goal. Changes in core behaviours, comparisons between different teams, and leadership impact also provide measures of progress and insights to help refocus future waves of change.

Leading organisations regularly track key risk culture indicators and incorporate them into senior management risk reporting. In addition to the behavioural analytics metrics, proxy indicators such as staff turnover, risk limit and compliance breaches, and percentage of staff completing risk and compliance training, can be leading indicators of risk culture problems – especially if granular reporting permits the identification of pockets of inconsistent risk culture.

Monitoring efforts can be particularly, though not exclusively, concentrated on areas previously raising concerns, or where there are other high-risk characteristics such as new business units, fast growing or remote businesses, and uptick in key risk indicators.

5. THE DOCTOR'S ADVICE

Understanding and changing risk culture is not natural for many financial services organisations. It requires greater insight into culture and behaviour, the development of new skills, and sustained effort and monitoring at all levels. If done effectively, it will build a new self-reinforcing set of behaviours that cements a more mature risk culture of risk taking and it will drive business performance.

OLIVER WYMAN

Financial Services

THE FUTURE OF THE UK LIFE INDUSTRY

TIME TO INVEST IN MASS MARKET RETIREMENT

MARSH & McLENNAN COMPANIES

Contents

INTRODUCTION

This report sets out Oliver Wyman's market projections for the UK life insurance industry[1] over the next five years, and our view on the key issues and opportunities that insurers will need to get right in order to win. In summary there are two stand-out strategic opportunities; firstly the UK's new flexible retirement system, and secondly the bulk annuity market which will help unwind the legacy defined benefit (DB) pension system. We expect that five years from now these new strategic lines of business will be extremely valuable and cash generative, attracting a much better rating than the life sector does today.

These opportunities will both require substantial capital investment, but will not generate significant cash over the next five years. Insurers will, therefore, need to push in-force management activities to generate the cash required and to cover shareholder expectations of increasing dividends. The next five years will require a complete reinvention of the industry, and the challenges and degrees of change needed are probably even greater than those we have seen over the past 15 years.

Throughout this report our projections are based on the average position across the industry. There is plenty of opportunity for any individual business to perform much better than this, and we set out our views on how this can be achieved.

1 We deliberately exclude the wealth and asset management industry from this definition. Several life insurers have very successful wealth and asset management businesses but these are outside the scope of this report.

1. EXECUTIVE SUMMARY

There is a massive shareholder value prize in the pensions market, but it will take five years to prove the shareholder case

The life industry has a huge opportunity to become the retail interface between the UK's workforce and pensioners, and their retirement savings. We forecast that in 10 years' time the industry will have £1,200 BN on insurance platforms, and will be paying pensions of around £35 BN per annum (p.a.).

Insurers who share this growth will be hugely valuable businesses, with long-term dividend growth prospects around 4% p.a. higher than today. Even if just half of this additional growth became factored into equity valuations, then average share prices across the industry would be more than 50% higher than today. Those companies that best capture these opportunities will significantly outperform this.

On the way to proving the growth potential, life insurers must focus hard on cash generation from the in-force book, particularly cost control, and illiquid investments

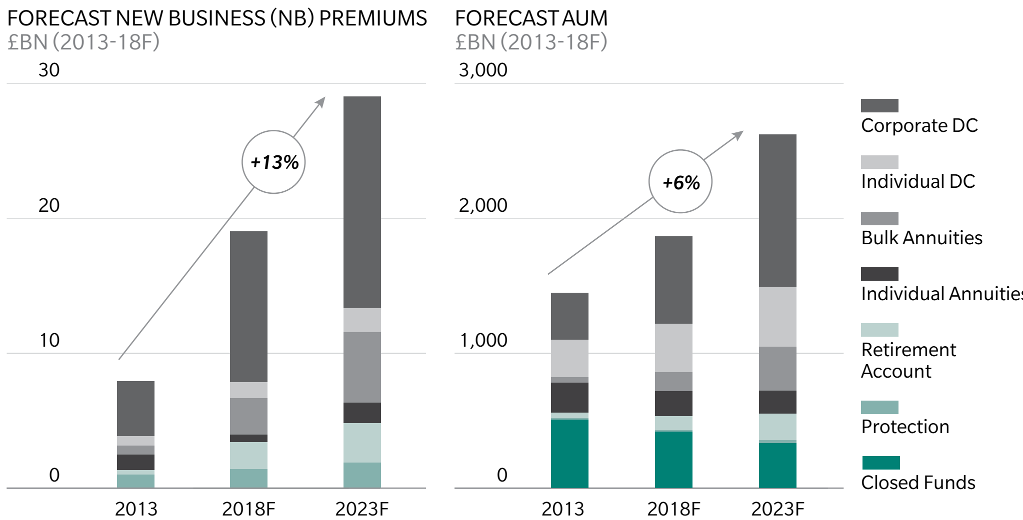
Becoming one of these winning businesses will require significant and radical investment in client propositions. However, average cash generation across the industry will be flat over the next five years. At the same time shareholders are becoming strongly focused on dividend growth as the main measure of long-term value. Therefore whilst investing for the future, insurers will also need to work their legacy assets harder, providing the additional cash needed to support their transformation. This will require a strong focus on back-book management[2], particularly on cost control and on building investment spread through higher yielding alternative asset strategies (e.g. illiquid investments).

Insurers will need to take bold decisions now about whether to invest to capture the huge upside in the bulk annuity market

The bulk annuity market will become a big industry in its own right. Margins will fall slightly from their current level, due to competitive pressures, and the market will remain capital intensive. However, within a few years the model will be sufficiently successful (in terms of profit and cash generation) to attract new capital. Longer-term we expect significant synergies between the management of bulk annuities and newer, more flexible Retirement Account propositions. There will be many pensioners with both types of policy, and the "payment" nature of the relationship with the annuity end clients will enable insurers to broaden their relationship and to build new direct-to-consumer (D2C) sales opportunities.

2 In this context, "back-book" is defined as all life business lines excluding the go-to market business lines i.e. pensions, protection and annuities. These business lines can be viewed as "closed" or "semi-closed" products with typically high margins but limited or no growth prospects.

Exhibit 1: There is a massive growth opportunity in pensions



We expect extremely rapid growth in the key strategic business lines of corporate defined contribution (DC), Retirement Accounts, and bulk annuities.

However, this will be offset in assets under management (AUM) terms by the run-off of the legacy book.

Protection will continue to grow relatively slowly, though Group business will benefit from the final stages of the DB to DC trend, as the remaining funds that self-insure risk benefits switch to external insurers.

> *We forecast that in 10 years' time the industry will have £1,200 BN on insurance platforms, and will be paying pensions of around £35 BN per annum (p.a.).*

2. A NEW ROLE FOR THE INDUSTRY

For most of the 21st Century the UK life industry has been on the defensive, retreating from formerly profitable lines of business in wealth management and unable to make strategic decisions in the face of legal and regulatory uncertainty, e.g. from the regulator's new conduct risk regime and Solvency II developments. The life industry now has a more clearly defined role in the economy, serving as a private sector component of the social security system, helping workers to save for their retirements, to manage their savings post-retirement, and to protect themselves and their dependents from major risks to their employability.

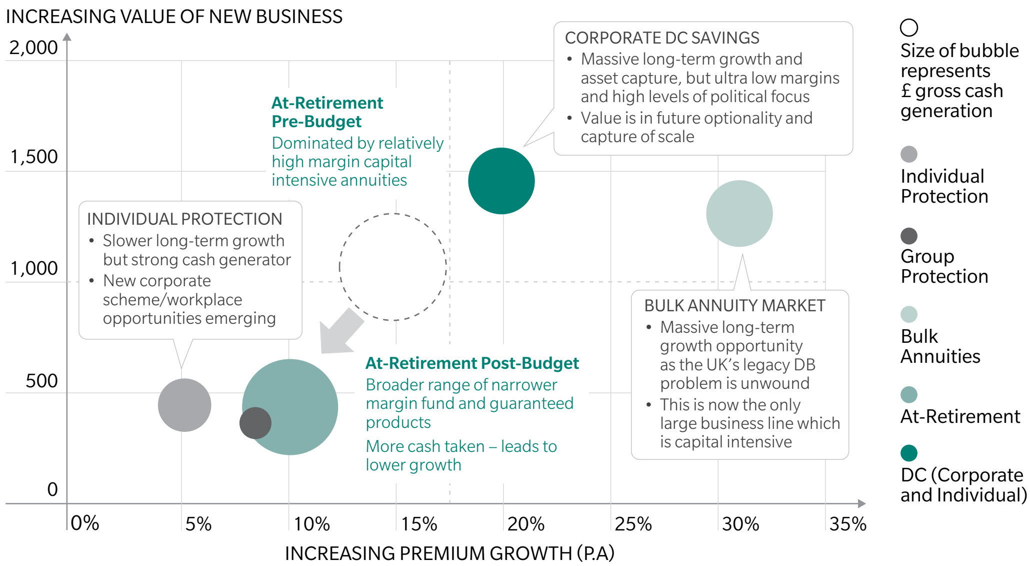
Over the next five years the industry will complete its shift towards serving these mass markets social security needs. We have reviewed our forecasts of the UK life market to reflect the UK Budget 2014, and our best estimates of the impact on clients, distributers, and manufacturers. Exhibit 2 sets out our views on the growth, new business profitability, and cash generation, for the five main open industry business lines. The stand-out opportunity is the pension scheme de-risking or bulk annuity market, which we expect will capture between 25% and 50% of the UK private DB scheme assets of £1,200 BN over the next 20 years. The other enormous opportunity is in building new flexible propositions (which we are currently calling "Retirement Accounts") to meet client needs across both the retirement accumulation and income life stages.

Exhibit 2 does not include personal investments and other older product lines which are no longer actively sold, such as endowments. There are still opportunities in with-profits and other forms of investment guarantee, but in our view these will be more powerful as structured funds made available within flexible Retirement Accounts.

The stand-out opportunity is the pension scheme de-risking or bulk annuity market, which we expect will capture between 25% and 50% of the UK private DB scheme assets of £1,200 BN over the next 20 years.

Exhibit 2: Shareholder value creation will be driven by the Retirement and Bulk Annuity markets

PROJECTED UK LIFE MARKET PROFIT POOLS (INCLUDING ALL THE AT-RETIREMENT MARKET)
2018F VALUE OF NEW BUSINESS (£ MM), NB PREMIUM 5 YEAR CAGR*1



*1 Compounded annual growth rate (CAGR)

The emerging clarity and importance of life insurers' role in our society and the "guaranteed" flow of business that this gives rise to, also exposes insurers to an increased level of governmental scrutiny, similar to other industries supplying products that are "essential" for modern life, such as utilities. The end-client will need to be at the centre of insurance decision making. Where individual insurers fall short, we will see regulatory action; where the industry falls short, we will see wholesale government rule changes.

3. HOW TO GROW SHAREHOLDER VALUE

A. Retirement Accounts (and At-Retirement)

In our view the pre-Budget 2014 annuity system had a sound economic rationale for the economy and society as a whole, but it was too paternalistic for modern investors, regulators and markets. We expect annuities will continue to play a key role in the retirement income market, but will also be complemented by newer, more flexible Retirement Account propositions. These new propositions will be significantly less profitable than annuities, but will also be less capital intensive, which will reduce constraints on funding growth.

Retiring workers have until now been forced to make a “once and for all”, high stakes decision about buying an annuity at a single point in time. This will now be replaced by a series of smaller decisions, requiring support from the provider (as well as advisers, where relevant) and, potentially, some form of direct contact. In the short-term pensioners will withdraw more cash from the system, but over the longer term overall retirement flows will increase because (post-budget) pensions are now more attractive products.

Exhibit 3: New flexible Retirement Account propositions will meet a broad range of client needs

	Transition to Retirement	**At-Retirement** Likely less relevant in future	**Post-Retirement**
RETAIL SPACE			
Life time annuity *(standard, enhanced, impaired)*		Enhanced annuities	Late age annuitisation
Other annuities *(Fixed term, deferred, variable, long-term care)*	Transitional products e.g. Variable Annuities	Unbundled longevity risk	
Other retirement income *(Income Drawdown, Equity Release)*	Regular premium survival benefits	Lump sum survival benefits	Equity release
Investment type *(ISA, funds)*	Asset consolidation	Platform-type solutions to manage retirement needs (investment + income + protection)	
Innovation/ new retirement products	Innovations focusing on flexible retirement e.g. (phased survival benefits + minimum income stream)		
Other *(funeral, health, retirement related services)*	Natural adjacencies (e.g. protection)		
B2B SPACE			
Bulk annuities	Further strengthen and develop position in bulk annuity space Vertical models to access customers’ other financial needs		

We expect sales of individual annuities will stabilise at around £5.4 BN for 2015, and grow to £6.2 BN by 2018.

At the time of writing it appears likely that the Government's guarantee of face-to-face retirement guidance will be provided by a separate government sponsored service independent of the industry, with a significant digital component to delivery. If this is the case, then the current provider/distributer structures in the market are likely to survive the introduction of the guarantee, but will need to evolve rapidly as the impact on clients becomes clearer.

We see the annuity market becoming wholly underwritten because all annuity clients will need to be tested for eligibility for enhanced rates. Therefore the annuity market is likely to behave more as a continuation of the enhanced rather than the traditional market. Many clients will continue to value the long-term safety that annuities provide, at least for part of their retirement savings, but we expect that most small case size in-house conventional annuity reversions will be replaced by simple cash and fund products. We expect sales of individual annuities will stabilise at around £5.4 BN for 2015, and grow to £6.2 BN by 2018.

There has been much speculation that asset managers will displace insurers in post-retirement savings management. Some asset managers will surely succeed, given their existing client base and ability to attract customers with very focused, affordable and customer-centric propositions. However, many asset managers do not yet have the deep retail capabilities and customer reach required. Moreover, we expect many retirees will elect to maintain their existing pension wrapper through retirement for their key income, tax and investment decisions (in some cases, due to inertia). Over the short-term, this will act as barrier to entry for the broader asset management industry, and will provide a window for the insurance industry to build winning propositions and to engage with its clients. Many asset managers will focus on providing funds to open architecture platforms.

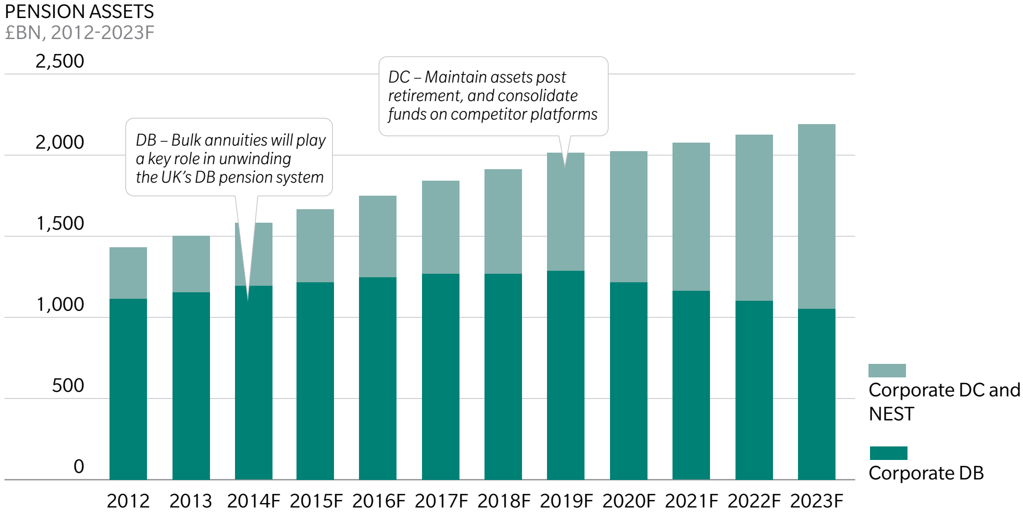
B. DC Pensions Savings

After the final stages of Auto-Enrolment have been actioned, practically all UK workers will be making regular contributions to a DC pension scheme. In addition, the 2014 budget has made pensions a much more attractive product and together these changes will fuel massive long-term growth. By 2023 we expect that the five or six players still active in this market will have combined assets of over £600 BN on accumulation platforms, with new money flow of around £50 BN per annum.

Margins will continue to be slim. Most insurers will aim to achieve a significant take-up of their own funds on the platforms, but low-margin passive funds will take an increasing share either through direct links, or as part of core-satellite structures. The core client proposition will need to be profitable on a platform basis, and where insurers are successful in selling their own funds this will deliver additional spread.

Exhibit 4: Projected growth in DC funds and sources of At-Retirement flows

FORECAST TOTAL UK CORPORATE DB AND DC PENSION ASSETS



RETIREMENT FLOWS

- Personal pensions
- Additional voluntary contributions (AVCs)
- Self-invested personal pensions (SIPPs)
- IFA-led consolidation
- Self-directed SIPP consolidation

›

- Unbundled trust retirements
- Management of funds post-retirement – with new products
- Retirement accounts

›

- Bundled DC retirements
- Automatic consolidation
- Accumulation platform-led consolidation

However, as the system matures insurers will be able to build broader financial relationships with their DC clients, providing them with other services and products. Take-up rates for individual savings accounts (ISAs) and other workplace products are still low because there is no real client interaction and insurers do little to initiate or manage engagement. This will slowly change as the UK's culture of pension saving shifts toward the Australian and American cultures, with increasing focus on building wealth in the pre-retirement accumulation phase.

Winning insurers will develop new models for helping clients to access appropriate guidance or advice, and to get the right retirement outcomes. These will be primarily digital models, with a broad suite of offerings tailored for different client segments at different life stages. But they will also provide cheap and effective human interaction where necessary, either for key decisions or to support the relationship.

The insurers who get this right will be viewed in a different and more positive light by end customers. The perception of these insurers will move from being sterile product providers sending out annual letters and providing unused websites, to being active long-term savings partners. At their best, these firms will provide virtual branches where they help clients with a broad range of financial and life needs.

C. The Pension Scheme De-risking Market (Bulk Annuities)

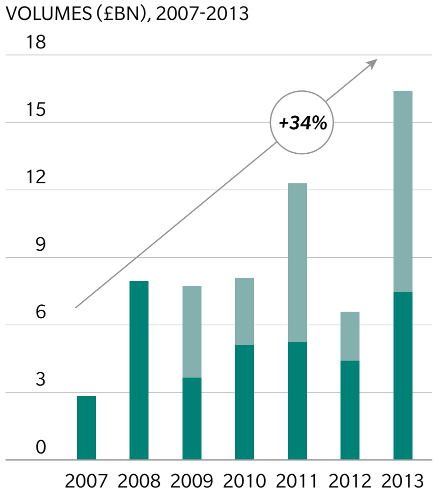
The insurance industry will play a major role in unwinding the UK's legacy DB system. This will be achieved primarily by bulk annuity buy-ins and buy-outs, but also by a significant flow of longevity swaps. We expect that the market in 2014 will be around £14 BN of bulk annuity transactions, and that in total there will be over £100 BN of transactions over the next five years. The main downside risks to this would be a reduction in long bond yields or lower equity market levels.

The margin on bulk business is currently more attractive than individual annuities; the client price is on average around 70-80 bps p.a. more expensive than in the enhanced annuity market. We expect there will be several new entrants to the bulk market as individual annuity businesses seek to replace lost volume after the 2014 Budget, but growth in the bulk annuity market should be strong enough to absorb this new capacity and pricing should remain attractive in the long run. Margin levels are hard to predict, but in our view if pricing does deteriorate, then this is likely to be much less than 50 bps p.a., and could be offset by building asset side margin through additional illiquid investments.

Exhibit 5: We expect over £100 BN of bulk annuity transactions over the next five years

RISK TRANSFERS DEALS HAVE RECOVERED FROM THE CRISIS DOWNTURN[*1]

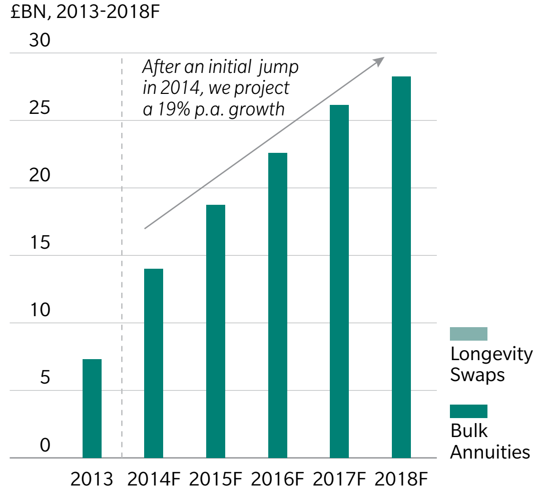
VOLUMES (£BN), 2007-2013



- Over £60 BN of pension scheme liabilities have been transferred to insurers, reinsurers or banks since 2007
- Of which about £25 BN via longevity swaps

WE PROJECT STRONG GROWTH OVER THE NEXT FEW YEARS PREMIUMS

£BN, 2013-2018F



- Massive latent demand from corporate sponsors who see DB liabilities as a big economic problem and distraction with no economic upside
- Low long-term interest rates – driven partly by quantitative easing (QE) – made bulk annuities unaffordable to most schemes during the crisis
- Sales in 2014 are well ahead of 2013, and we expect strong growth from here at around 19% p.a. from 2014 onwards

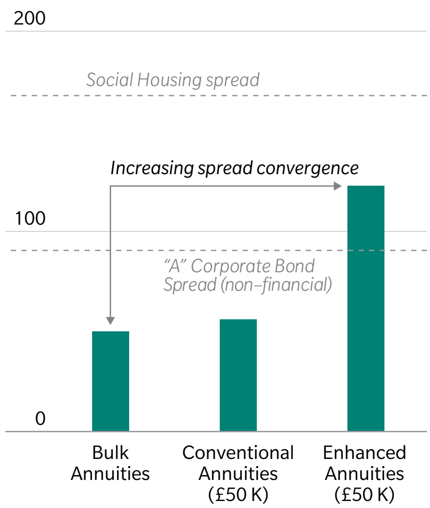
*1 Buy-ins, buy-outs and longevity swaps

Source Oliver Wyman analysis, Hymans Robertson; LCP; Pensions Institute report; JLT; PPI

Exhibit 6: Bulk annuity demand growth will underpin margins

THE IMPLIED SPREAD PASSED ON TO CLIENTS IN PRICING IS MUCH LOWER IN THE BULKS MARKET THAN IN INDIVIDUAL ANNUITIES

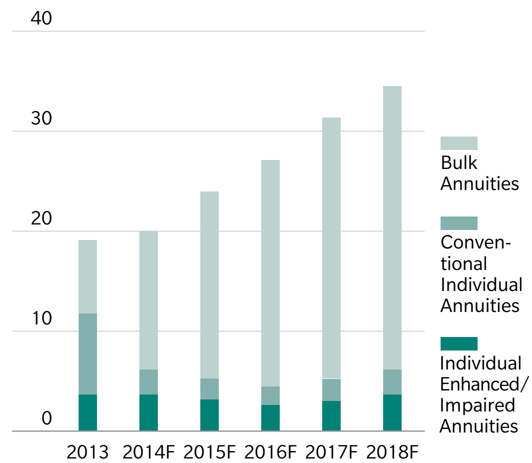
BPS SPREAD TO SWAPS



- Based on quotations in early 2014
- Bulk annuity pricing is best for providers
- Market pricing currently can be achieved with relatively low exposures to illiquids
- Conventional market likely to become just the healthier end of enhanced
- The enhanced market has gone from being the highest margin part of the annuity markets to the lowest

BULK MARGINS WILL CONTRACT AS COMPETITION INCREASES BUT MEDIUM TERM SHOULD REMAIN HEALTHY

ANNUITY PREMIUMS £BN, 2013-2018F



- It is highly unlikely that there will be any significant contraction in overall annuity sales, considering individual and bulk business combined
- We expect a tightening in margins as new entrants begin to price bulks much more competitively

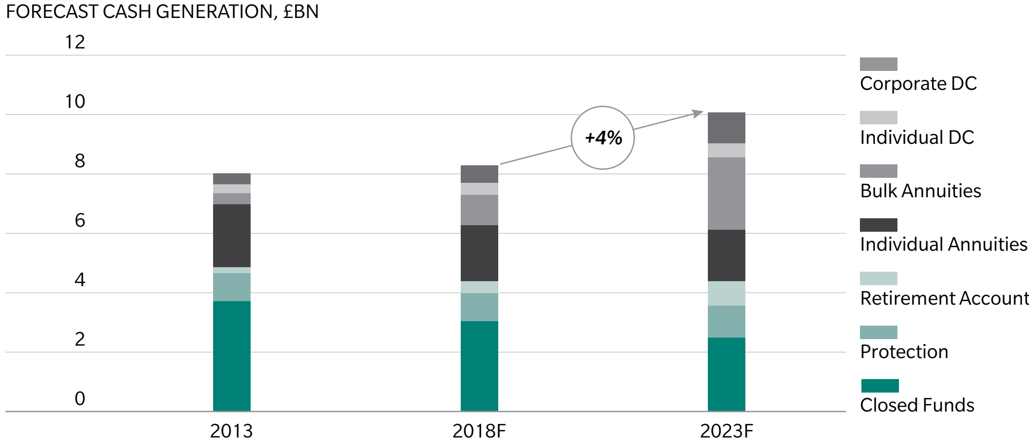
4. HOW TO BUILD A NEW MORE VALUABLE STRATEGIC BUSINESS

Five years from now successful life industry players will have established themselves as the retail interface between the UK's working population and pensioners, and their retirement savings. We forecast that in 10 years' time the industry will have £1,200 BN on insurance platforms. This will notionally be split £1,000 BN in accumulation, and £200 BN in decumulation, but the distinction will be blurred and the winning platforms will be able to meet both categories of client need. The industry will also be paying pensions of around £35 BN p.a.

Insurers who share this growth will be hugely valuable businesses, with long-term dividend growth prospects around 4% p.a. higher than today. Even if just half of this additional growth became factored into equity valuations, then average share prices across the industry would be more than 50% higher than today. Those companies that best capture these opportunities will significantly outperform this.

Exhibit 7: It will take five years before the new retirement platforms begin to drive earnings growth

FORECAST CASH GENERATION, £BN



- Between 5 and 10 years from now we expect that cash earnings from the new core retirement businesses will begin to accelerate
  - Picking up the baton from closed life which will by then be in fairly rapid run-off
- Retirement Income assets will still be relatively small compared with their long-term potential, but will be growing fast and will be a clear long-term driver of shareholder value
- The most important way of supporting this is to maintain market leading platform efficiency
  - Both for customer engagement and for cost management
- By this time the bulk annuity business will also be sufficiently mature to contribute to distributable earnings significantly

We forecast that in 10 years' time the Industry will have £1,200 BN on insurance platforms.

However current business models cannot deliver this growth. The new retirement businesses will be platform-based with strong customer engagement models, digital client journeys, and the potential to build a D2C business over time. For clients with advisers they will offer a digital independent financial advisers (IFA) proposition, which will dovetail with the end proposition, and will offer an adaptive mix of advised and self-directed decision making. They will need to be capable of delivering huge economies of scale as asset volumes grow over the next five years.

Achieving success in these opportunities requires a much higher level of understanding and engagement with the end clients than insurers are used to. At the same time the propositions they offer to clients and advisers must provide the best bespoke retirement process for each. A critical decision will be to decide the firm's appetite and strategy around direct distribution, guidance and advice. Customers will seek out help to support their multiple retirement decisions, and are likely to place business where they find this help. Insurers cannot afford to let the fear of regulatory risk stop them meeting this demand. Conduct risk issues will remain, but it is expected that the regulatory uncertainty that has prevented insurers (and others) developing simplified advice models will start to be addressed by the Financial Conduct Authority (FCA), allowing insurers to more confidently deliver guidance, execution-only and simplified advice models, with a focus on automated processes, digital channels and mobile.

Exhibit 8 sets out how winning insurers can build propositions with the right attributes and components to engage clients profitably.

Exhibit 8: Delivering the new Retirement Proposition

1. CUSTOMER SELECTION AND ENGAGEMENT

Customer segmentation and profit pool analysis by characteristics such as wealth, appetite for advice, risk/return preference

Strategy on advice or guidance

Customer journey design blending pre-, partial and post- retirement

Maximise customer retention and fund consolidation pre-and post- retirement

Enhancing the customer experience via digital information and planning tools and streamlined servicing proposition

Improved customer communications for more complex options and propositions

2. PRODUCT PROPOSITION AND PLATFORM

Enhanced pre- and post retirement product suite including:

- Blended accumulation/ decumulation products
- Phased retirement products
- Income drawdown
- Guarantees and target income/return products
- Collective pensions

New skills e.g. longevity risk, bulk annuities

Platform development (including own investment platforms and links to other platforms)

Consolidation capabilities, as offensive or defensive strategy through IFAs and direct

3. DISTRIBUTION

Understanding channel value and evolution (D2C, in-house reversion, IFAs, EBCs, partnerships, etc.)

Coherent joint adviser/end client proposition

Channel strategies (IFA, execution only brokerages, direct, vertical integration)

Building digital capabilities e.g. interface/platform for IFAs, planning tools for IFAs (& customers)

4. ORGANISATIONAL AND BUSINESS CAPABILITIES

Innovative Customer Platform

Use of digital to:

- Improve customer experience
- Achieve lower cost of servicing

Data and Analytics

- Customer understanding and targeting
- Predictive behaviour modelling
- Pricing

Cost and Capacity

- Rigorously transform cost base to reflect lower-margin retirement market and increased customer servicing pre and post-retirement

Conduct Risk

- Enhanced management of "retirement risks"), and risk from providing advice, guidance

Organisation and Culture

Core skills:

- Understanding and responding to customer needs
- Innovation and speed
- Data management and analytics

Exhibit 9: A New Approach to Systems Build

EXAMPLE: DIGITAL BUSINESS LAUNCH - MILESTONES ROAD-MAP (PARTIAL)

KEY CHANGE/ DELIVERY MILESTONES

~12 months → *Launch*

PROPOSITION	Product strategy and scope defined	Product set and economics confirmed	Legal and Compliance review completed	Product catalog active	Marketing campaign execution initiated
PROPOSITION	Content library confirmed	Marketing strategy complete	Value proposition design articulation	Realisation plan, agency, email senders/receivers, websites, scheduling	
PROPOSITION	Differentiators defined e.g. "People Like You"	Proposition design input completed	Priority functionality produced for website/digital interactions	Key differentiated digital features in place (pre-production)	Content, features and digital functionality live
TECHNOLOGY	Technology architecture determined	Vendor engagement in place	Agile rapid iterative development executed	*Version 1.0* locked	Beta testing complete
OPERATING MODEL	Operating model design outlined	Product fulfillment processes designed	BAU organisation and roled defined	BAU org and support structure recruitment/ training	Operating model structure live and ready
GOVERNANCE AND ECONOMICS	Initial economic model produced	Forecasting and volume modeled	P&L structure, economic analysis, and KPI's developed	BAU/ongoing reporting and tracking prelaunch	MI, Reporting, P&L and tracking live

There is not much time to achieve this. If the new propositions are to be ready for 2015 (and fit to evolve rapidly thereafter) then a new radical approach to build is required. The development must focus on the required dates and the need to deliver a flexible approach that uses new technology solutions rather than traditional bottom-up assessments of systems build and cost.

The industry will be managing an extremely fast growing low-margin business, and at the same time will need to demonstrate to shareholders that it can support a growing dividend. Therefore increasing cash generation will be vital, but if current business models are retained then we expect that cash generation will be broadly flat over the next five years. Distribution will change fast and this will provide opportunities for deep cuts in distribution and distribution coverage costs. However, this will not be sufficient to deliver the savings required and the industry will have to extract more value from its in-force books.

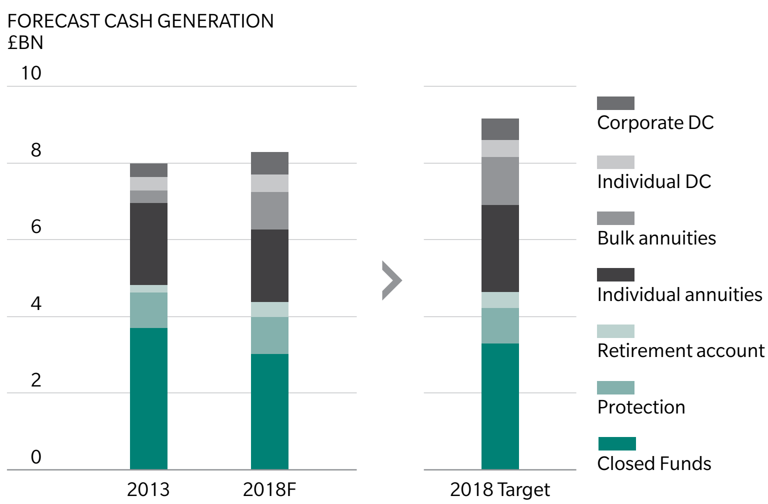
5. WORK THE IN-FORCE BOOK

It is extremely unlikely that there will be any significant injection of new capital into the life insurance industry over the next five years (except in the bulk annuity market). The cash for dividends and strategic investments will have to be self-generated by an aggressive push into better in-force management. In particular, cost bases will need to be reduced, and asset spreads will need to be enhanced through more extensive investment in illiquid assets.

Many of the larger life insurers have already carved out their in-force books so that they can be run as separate coherent businesses, often with different clients, products and distributers from the their strategic open businesses. This will enable an improved focus on optimising financial, customer and cost management. We expect more companies to adopt this model to improve the ability to optimise financial, customer and cost management of the back-book for cash generation. This also improves strategic optionality and helps to clarify the sources of cash and creation of long-term value across the Group.

Exhibit 10 below shows that around half of industry level cash flows currently flow from the in-force closed business lines, but unfortunately this will decline by around 20% over the next five years unless there is further action to enhance earnings. Overall we expect that cash flow earnings across the industry will be broadly flat over the next five years, and that this will not be sufficient. We believe that across the industry there will need to be an additional £1 BN p.a. generated by 2018 to invest in the continuously evolving retirement propositions, and to meet shareholders' dividend growth expectations.

Exhibit 10: Overview of back-book management



LEVERS OF VALUE CREATION TO ACHIEVE TARGET

Improved In-Force Management

- Commercial effectiveness for back-book clients
- Operational efficiency and effectiveness
- Financial management

Annuities

- Increased investment in illiquids

Exhibit 11: How to work the back-book to achieve strong cash generation targets

COMMERCIAL EFFECTIVENESS FOR BACK–BOOK CLIENTS

Galvanise existing client management approaches/ better leverage existing customer database
- Cross-selling
- Up-selling
- Encourage further deposits

Improve customer retention approaches
- Maturity management
- Orphan management
- Persistency management
- Death/inheritance management

Restructure low profitable contracts
- Change crediting rate (differentiate by cohorts, buffer policies)
- Increased contractual fees
- Reduce guaranteed rate
- Make sure all contractual fees are invoiced
- Policy mutation
- Remove non-profitable options

OPERATIONAL EFFICIENCY AND EFFECTIVENESS

Structural Cost Optimisation
- Review and redesign processes
- Optimise IT and contract management service
- Nearshoring/offshoring
- Renegotiate commission rates
- "Survival/strategic minimum" approach

Cost Variabilisation
- Outsourcing (processes or full book)
- Multi-skilling of staff

Claims optimisation
- Differentiated claims handling
- Aggressive sourcing strategy
- Medical outcome management
- Fraud and recoveries

FINANCIAL MANAGEMENT

Revisit ALM strategy to increase return and/or decrease risks
- Authorised asset classes
- Strategic asset allocations
- Dynamic asset allocation
- Segmentation of traditional funds/segregated funds
- Hedge downside risks

More structural approaches to de–risk
- Reinsurance
- Securitisation

Decrease SCR/Risk margin
- Internal Model
- Optimisation/risk framework optimisation
- Risk mixer

Optimise internal corporate structure
- Legal entity restructuring

Usually treated separately from back-book optimisation

CLOSED BOOK MANAGEMENT

Separate closed book management
- Manage differently with an increased focus on cost
- Carve out/create a specific entity

- Exit opportunities: to monetise directly back-book

- Acquisition opportunities becoming a closed book specialist

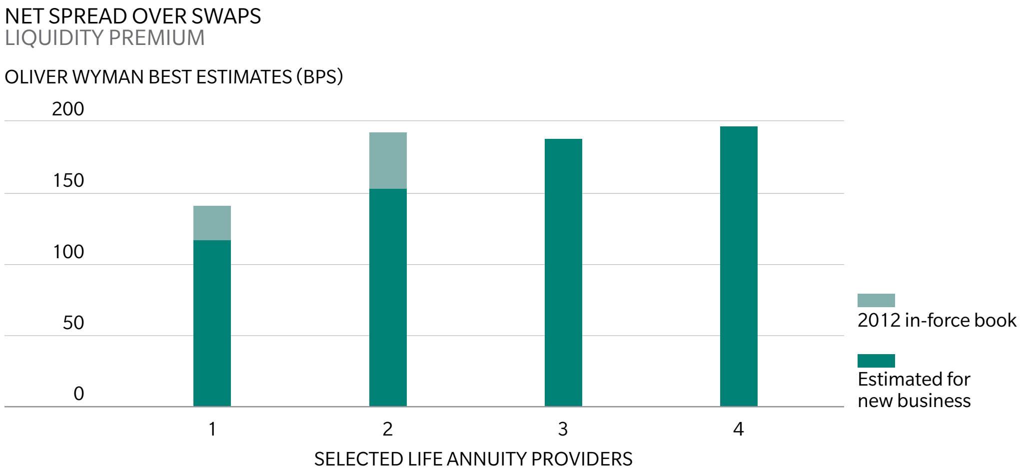
This £1 BN target is equivalent to achieving an additional spread of around 20 bps p.a. on annuity liabilities from illiquid asset investment, plus a further 10 bps p.a. on other in-force assets through broader management initiatives. Exhibit 11 sets out our holistic framework for assessing and prioritising all pockets of in-force value opportunity.

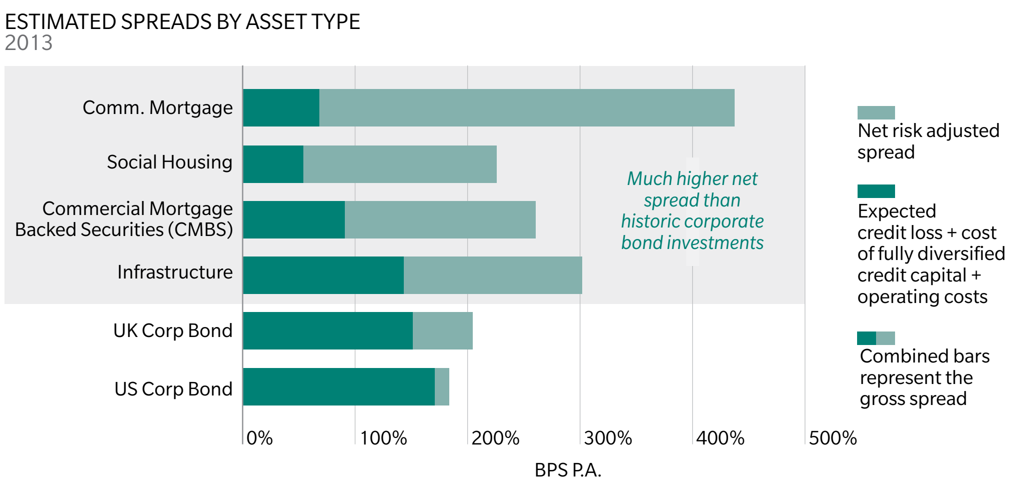
Winning life insurers will set themselves strong targets for working the back-book, the target we have set out above is achievable, but very different in application across the industry. We estimate that if these targets were achieved across the industry then this would support both cash flow generations and dividend growth of around 3% p.a. for the next five years. This is only slightly lower than our expectation of 4% p.a. growth for retirement platform businesses across the industry by that time, therefore we expect that successful in-force management will be an essential underpin for share prices during the difficult industry transformation.

There is still huge potential to build spread from illiquid investments

Life insurers are natural providers of long-term fixed rate financing to the UK economy. The insurance industry has a large and rapidly growing block of individual and bulk annuities that are inherently illiquid because clients have little optionality concerning the schedule of payments. The predictability of life insurers' liabilities means they can safely make illiquid investments, capturing significantly higher spreads than they could earn from investment in liquid capital market instruments.

Exhibit 12: The focus of illiquid investment will shift from supporting annuity pricing to building shareholder cash spread





The principal opportunity is in commercial mortgages. Prices are mainly set by banks, which need high-margins to compensate them for the liquidity risk they face (which insurers do not), and the stock of commercial mortgage assets is similar in size to the £270 BN stock of annuity liabilities[3]. However, in the other popular areas of social housing investment and infrastructure finance, insurance and pension fund demand has already compressed spreads.

Those companies that best capture these in-force book and illiquid investment opportunities will significantly outperform our targets. Leading insurers can already achieve in-force pickups of up to 50 bps p.a. on their in-force books, or five times the target set out above. Similarly an illiquid asset pick up of just 20 bps is small relative to the improvements that enhanced annuity providers have achieved over the past two years or so. A strong in-force management strategy is a pre-requisite for success over the next five years.

3 As at year end 2013.

6. CAPITAL, VALUE AND MORE INDUSTRY CONSOLIDATION

More in-force consolidation is coming

We expect further consolidation in the life industry, mostly in back-book acquisition. The case for retaining back-books within a broader insurance group is breaking down, and five years from now we do not expect to see many significant mixed businesses left in the market:

- Insurance management teams are now radically unlike those that built the back-books over previous decades. They do not see a return to the broader product ranges of the past as feasible, and view the in-force book as an asset whose value should be maximised
- Rising interest rates and recovering equity markets have significantly improved the economics of closed with-profits funds. The sale of a back-book can now be seen as a way of releasing capital to invest in promising opportunities rather than simply the disposal of a problem
- The Solvency II transitional arrangements delay the on set of stricter capital requirements for back-books
- The shareholder value of the back-book can be improved by the added clarity of value and the option to sell
- There may also be some front-book consolidation, particularly sales by those insurers who have failed to make the transition to the new platform-based retirement market, who are unable to achieve economies of scale or who have failed to build attractive propositions that can be sold profitably

The relationship between capital and strategy

Improved cash flow generation is key for future investment and dividend growth. However, we expect that these will also be supported by reduced capital requirements across the business, and successful in-force management will be a strong source of one-off savings here. In addition, the capital intensity of the open businesses will reduce due to the lower capital requirements for protection and unitised business under Solvency II, and the reduction in sales volumes for new individual annuities. We expect that the reduction in individual annuity volumes in-force across the industry will release around £3 BN of capital over the next five years.

The big strategic capital issue for all life insurers will be whether or not to participate in the capital intensive bulk annuity market. Those which do not, will be on a path to a future as a mass market retirement asset platform provider, with smaller protection and individual annuity businesses attached. These will be cash generative businesses with very little need for new capital other than for acquisitions, and will be assessed by shareholders on the basis of assets under management (AUM), growth in assets, and bps margin generation. As they transition they may also be more likely to sell their in-force books.

Those life insurers that participate in the bulk annuity market will continue to be risk managers, and will maintain strong asset liability management capabilities. These businesses are also more likely to be active in acquiring in-force books, in order to improve the return on their risk management capabilities.

If the bulk market grows as we expect then it is likely that in the medium to longer term it will be less capital intensive because rising interest rates may allow margins to be increased. However, the industry as a whole will need new capital if market sales volumes are in line with our expectations, and this will require a very different approach to market communication. Lumpy bulk annuity businesses are unlikely to attract a high valuation multiple on new business earnings and (subject to market sentiment) and at the same time it is likely that the cost of new capital may be relatively high. These businesses will need to be active participants across the capital markets with very strong shareholder communication around capital management, value creation, and pricing and deal decisions. They have the potential to create huge amounts of shareholder value over the next 10 years.

7. WHAT TO DO NEXT

The next five years will require massive change in the UK life industry. It is likely that it will emerge as a more valuable industry, with a clearer role in society and the economy, providing mass market flexible retirement propositions, with much stronger customer engagement than today. We believe that those insurers who successfully make the transition will enjoy extremely rapid share price growth from that point on, in order to ensure that your business is one of the winners we recommend:

- Develop a strong in-force management strategy now with clear cash generation and capital release targets designed to meet your transition investment and dividend needs
- Begin building the new propositions now, use a structure that facilitates rapid evolution. Throw away existing IT development approaches and use new technology approaches based around delivery and timescale requirements rather than bottom up estimates of system change requirements
- Make the decision on bulk annuities now. Make sure that this is fully connected with your future capital and stakeholder management strategies
- Make several bets on retirement, be prepared for one or more to fail
- Be ready to innovate and to change rapidly. The market will change so fast that no proposition built today can be future-proof

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