CAPITAL GENERATION & LIFE INSURERS

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12 DECEMBER 2019

TRIPLE A
RISK FINANCE

FCG and dividend policy

- Paying (predictable) dividends essential for investors.
- Most insurers still express their dividends in terms of IFRS Net (Operating) Profit.
- Dividend targets typically in range of 40-50% of Net Profit
- Aegon has started to set dividend targets in based on Normalized Capital Generation

Insurer	Driver	Dividend policy
NN Group	IFRS operating result	40-50% of the net IFRS operating result
Aegon	Norm. Cap Gen	45%-55% of normalized capital generation
ASR	IFRS operating result	45% to 55% of net IFRS operating result allocated to the shareholders (net of hybrid costs)
Achmea	IFRS net profit	45% of IFRS net profit, to be allocated to the shareholders if Solvency ratio exceeds 130%
Allianz	IFRS net income	pay-out is 50% of Allianz Group IFRS net income (to shareholders) if sustainable Solvency II ratio above 160%
Generali	IFRS net income	Target pay-out ratio range of 55% to 65% if target average RoE > 11.5%
Ageas	IFRS net income	Dividend distribution ratio of at least 50% of the Group IFRS net result if sufficient resources are available

Source: Company disclosures

- Typical IFRS RoE targets in 7%-15% range
- Absolute "normalized" capital generation targets in addition

How to manage FCG in practice?

Improve understanding → Sustainable Capital Generation → Management & target setting → Management & target setting

Manage future free capital generation

Improve understanding

- FCG and risks for multiple future years
- Explain all FCG variances

Sustainable and Organic capital generation

- Assess organic capital generation net of market impacts and one-offs
- Assess sustainability of long term financial risks

Management and target setting

- Balance between risk exposures, stable capital position & dividend payments
- Strategic target setting

In control of the business

- Confront actual capital generation with targets
- Benefit from gained knowledge for future decision making

Strong variation in FCG reporting practices

- Reporting practice amongst insurers varies strongly and level of detail in the disclosures is low
  - Important elements for analysts to forecast future FCG most often not separately shown
  - Focus is on explaining the “variances”, one-off items and model changes, and the paid-out dividend.
  - There are still many changes to models and methodologies.

- Investors / analysts primarily interested in ability to generate future FCG
  - Without the underlying detailed components, investors cannot make their own analysis.

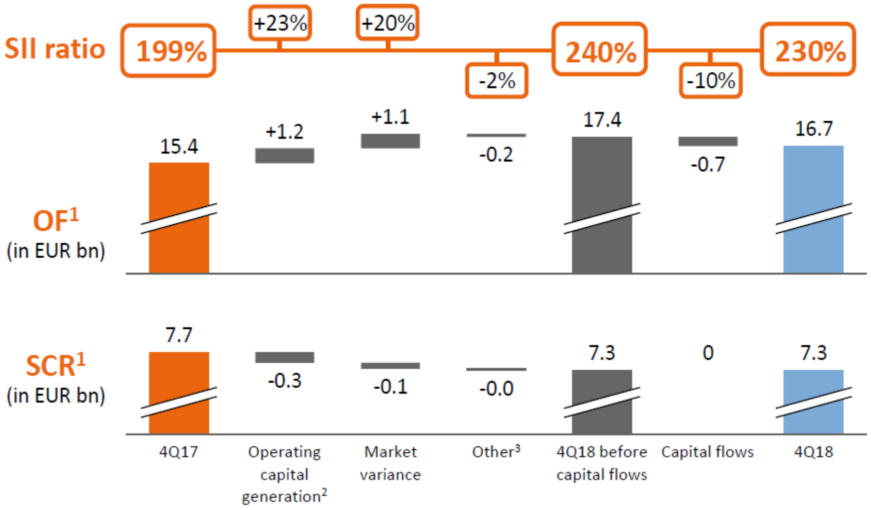
- Need for “FCG reporting principles” from CFO Forum?

(similar to EEV / MCEV)

Organic capital Generation	Incidental capital Generation
▪ Impact increased operational result?	▪ Impact B/S optimization activities
▪ Impact investment margins?	▪ Market developments?
▪ Impact expected release of capital and risk margins?	▪ Refinement of assumptions and internal models?
▪ Impact upstreamed dividends from other activities?	▪ Impact M&A activities?

Example FCG reporting NN Group

Solvency II movement FY18

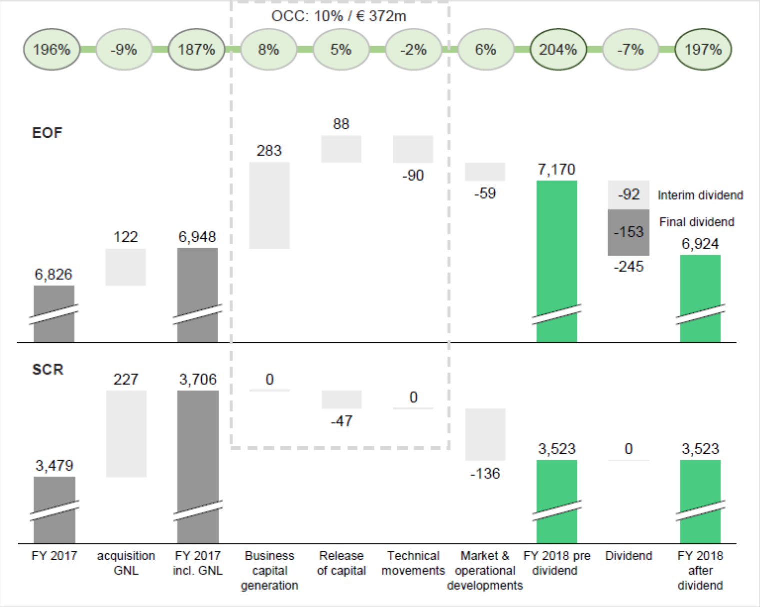


- Solvency II ratio increased to 230% driven by operating capital generation and market variance, partly offset by capital flows
- Operating capital generation of EUR 1.4bn in 2018 from Solvency II entities, Japan Life, Asset Management and pension funds, and includes holding expenses
- Market variance contributed positively to the ratio mainly reflecting the favourable impact from movements in credit spreads
- Capital flows reflect the 2018 interim and final dividends and the termination of the warrant agreement
- 1 January 2019 pro forma capital ratio of NN Life following legal merger with Delta Lloyd Life of 231%[4]

Source: NN Group analyst presentation FY18 results

Example FCG reporting a.s.r.

Solvency II ratio movements in 2018



- Strong organic capital creation of 10% pts SII (€ 372m)
- Impact of the acquisition of Generali Nederland represents the adjustment after legal merger and includes among other things the acquisition price and capital synergies (-9% points)
- Solvency II-ratio up, to 204% pre dividend and 197% after proposed dividend

* Excluding a.s.r. bank and a.s.r. vermogensbeheer

a.s.r.

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Source: NN Group analyst presentation FY18 results

Example FCG reporting VIVAT

VIVAT's Solvency II ratio increased due to longevity reinsurance, RT1 issuance and increase in the VA, partly offset by impact of re-risking

- VIVAT's Solvency II ratio increased from 162% at YE17 to 192% at the end of 2018
- Market impacts, mainly due to the increase in the VA from 4 to 24 bps, had a positive impact of 38 %-points on the Solvency II ratio
- Capital effects, which include the issuance of EUR 300 million RT1 notes partly offset by coupon payments on subordinated debt contributed 7 %-points
- The longevity reinsurance transaction had a positive impact of about 13 %-points on the Solvency II ratio
- These positive effects were offset by an increase in market risk, largely driven by re-risking of the investment portfolio, with a negative impact of 16 %-points and model improvements (-/-12 %-points)
- VIVAT's organic capital generation in 2018 is still limited mainly as a result of the UFR-drag and the low expected asset returns caused by a low exposure to market risks. The result of re-risking activities in 2018 has not yet been fully realised in the figures. Together with further re-risking activities, capital generation is expected to improve going forward

Change in Solvency II ratio in 2018

Allocation is based on management's best judgement

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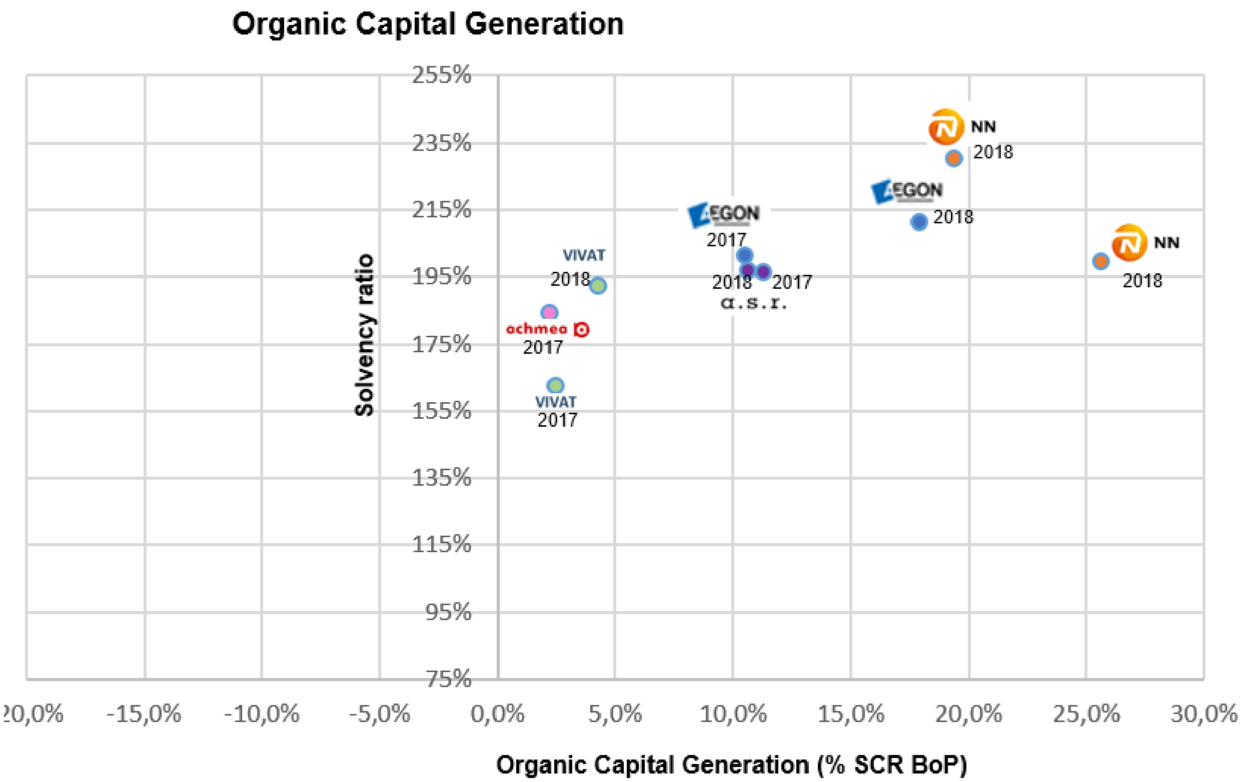
Outcomes Dutch insurers 2017-2018

€ bln	NN		AEGON		ASR		ACHMEA		VIVAT	
	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
S2 ratio	199%	230%	201%	211%	196%	197%	184%	198%	162%	192%
SCR growth (%)	41,6%	-5,9%	-32,2%	6,4%	4,2%	1,3%	-1,5%	-1,3%	-5,6%	3,7%
LACDT/Pre-tax SCR (%)	20%	18%	13%	14%	18%	15%	11%	14%	0%	0%
IFRS net income	2,1	1,1	2,4	0,7	0,9	0,7	0,2	0,3	-0,1	-0,3
(1) Change Free Surplus	1,1	3,2	2,5	1,9	0,8	0,5	0,1	0,6	-0,4	0,8
Capital flows	0,6	0,7	0,4	0,5	0,2	0,2	0,3	n.a.	-	-0,2
(2) Cap Gen	0,5	2,5	2,1	1,4	0,6	0,3	0,4		-0,4	0,5
Market impacts / One-offs	0,9	-1,0	-1,1	-0,0	-0,2	0,1	-0,3		0,5	-0,4
(3) Organic Cap Gen	1,4	1,5	0,9	1,4	0,4	0,4	0,1		0,1	0,1
(4) Divs + Coupons + SBB	0,6	0,7	0,4	0,5	0,5	0,2	0,3		-	-
Ratio (4) / (3)	0,43x	0,47x	0,42x	0,36x	1,29x	0,66x	3,09x		no div	no div

Source: company disclosures and Triple A analysis

Organic Capital generation 2017-2018

Large Dutch insurance groups



Source: company disclosures and Triple A analysis

Actual Capital generation 2017-2018

Selection of Dutch insurance entities

- Overview of outcomes of Capital Generation Dutch market
- Years: 2017 and 2018
- Life, Non-Life and Health
- Based on Power BI

SCAN ME

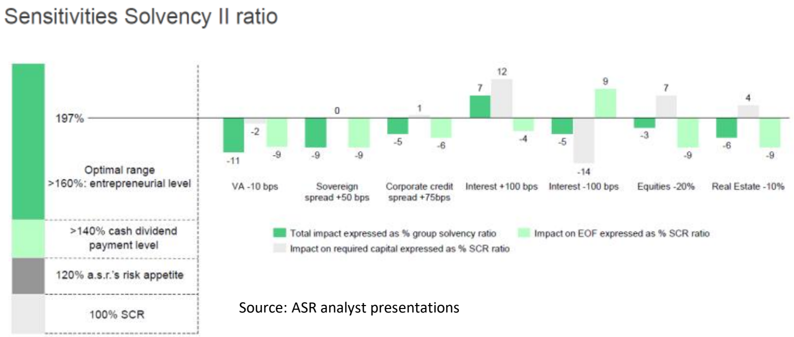
Are we in control of FCG?

- Risks and sensitivities disclosed through single stress tests

?? Sufficiently clear for investors??

?? Sufficient understanding of how FCG itself responds to sensitivities ??

a.s.r. example



Source: ASR analyst presentations

AEGON example

Solvency II sensitivities

(in percentage points, 1H 2019)

	Scenario	Group	NL	UK	US
Equity markets	+25%	+13%	+4%	-4%	+35%
Equity markets	-25%	-14%	-8%	-3%	-25%
Interest rates	+50 bps	+6%	+6%	+2%	+7%
Interest rates	-50 bps	-8%	-4%	-1%	-13%
Credit spreads[1]	+50 bps	+5%	+11%	+5%	+4%
Credit spreads[1]	-50 bps	-7%	-11%	-8%	-3%
Government spreads	+50 bps	-4%	-7%	-5%	+0%
Government spreads	-50 bps	+6%	+13%	+5%	+0%
US credit defaults[2]	~200 bps	-21%	n/a	n/a	-41%
Mortgage spreads	+50 bps	-5%	-13%	n/a	n/a
Mortgage spreads	-50 bps	+5%	+13%	n/a	n/a
EIOPA VA	+5 bps	+3%	+8%	n/a	n/a
EIOPA VA	-5 bps	-3%	-8%	n/a	n/a
Ultimate Forward Rate	-15 bps	-2%	-4%	n/a	n/a
Longevity[3]	+5%	-7%	-12%	-3%	-3%

Source: AEGON analyst presentations

What happened during the first half of 2019?

European Central Bank cuts its deposit rate, launches new bond-buying program

Economic parameters	2H18	1H19	Change
EIOPA risk-free rate (10yr)	73 bps	8 bps	- 65bps
EIOPA VA spread	24 bps	9 bps	- 15bps
Average mortgage spreads	114 bps	171 bps	+57bps

Overall solvency level still solid…

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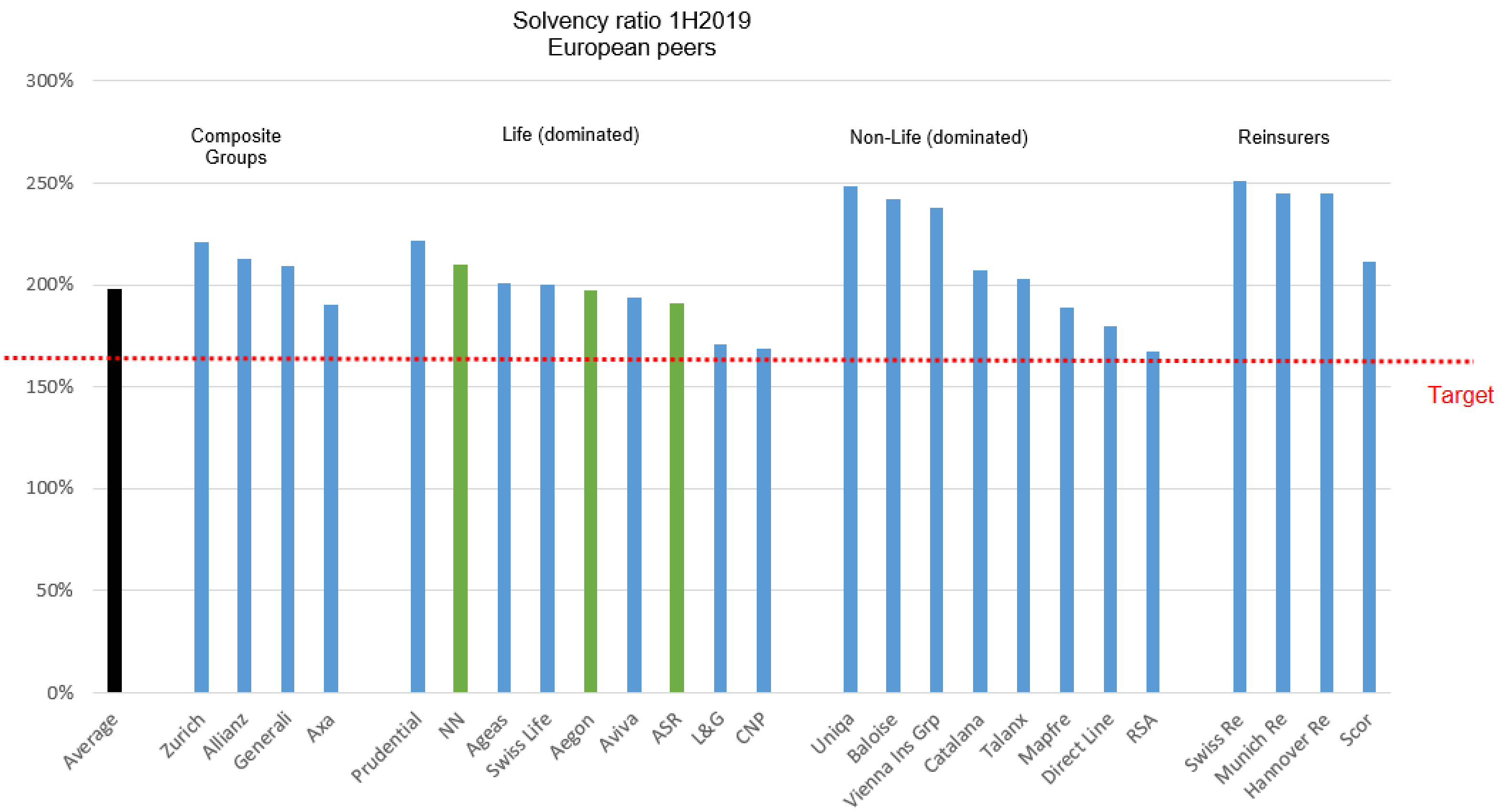

Source: Company disclosures

… but extremely volatile Capital Generation

Economic parameters	2H18	1H19	Change
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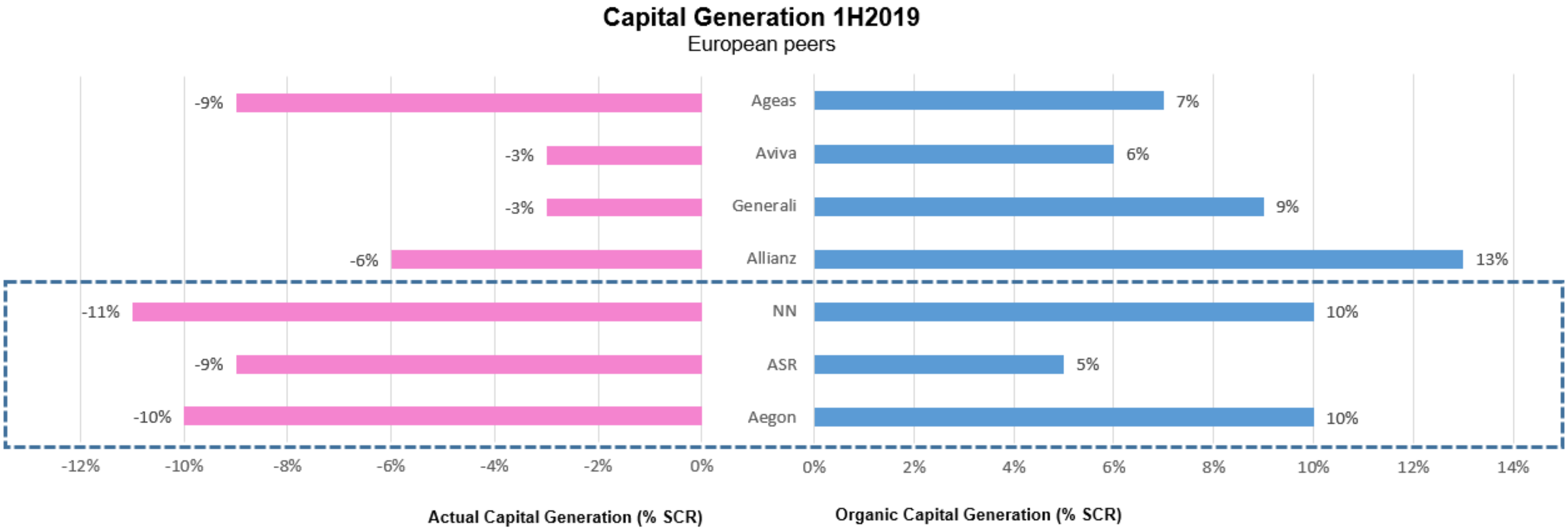

Source: Company disclosures

… and even solvency pressure based on "market" standards

Economic parameters	2H18	1H19	Change
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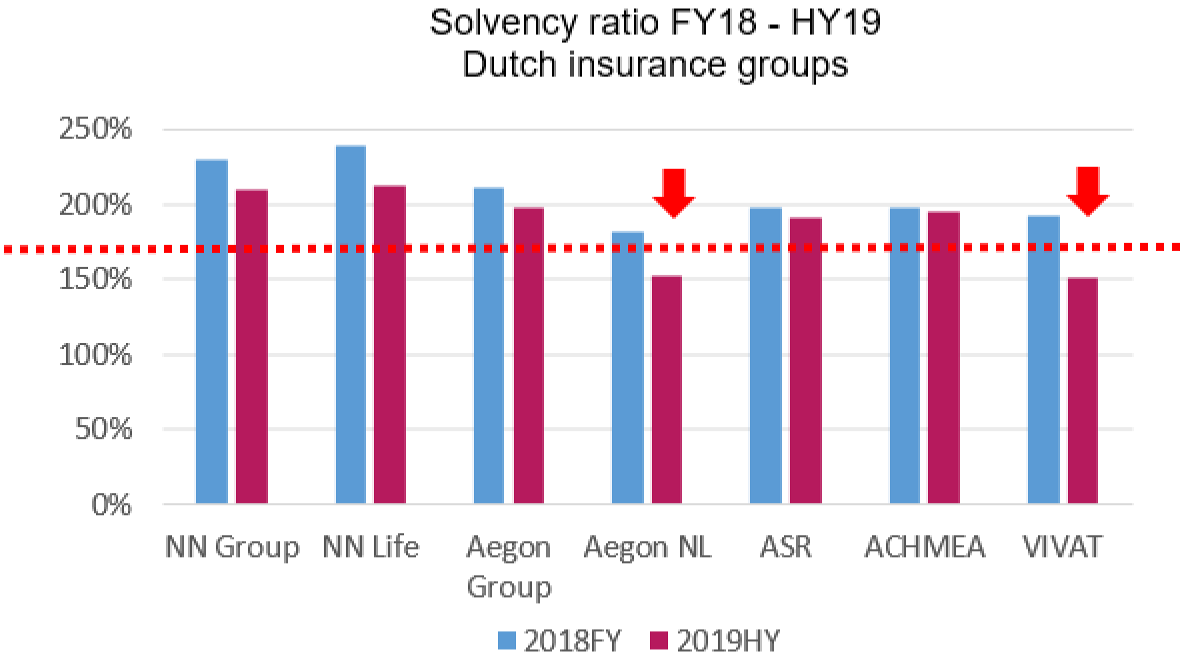

Source: Company disclosures and presentations on seminars

… and Dutch insurers heavily punished

Economic parameters	2H18	1H19	Change
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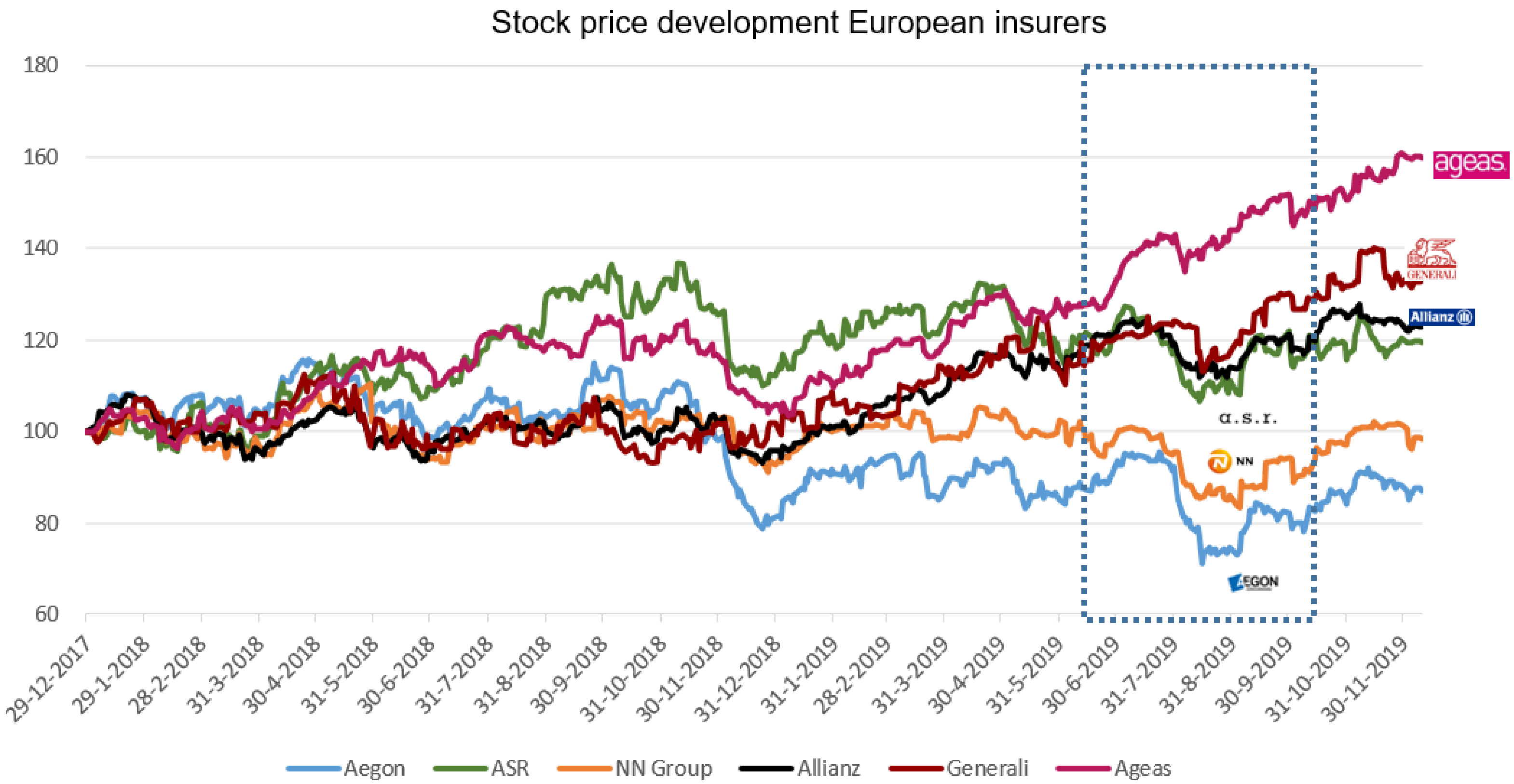


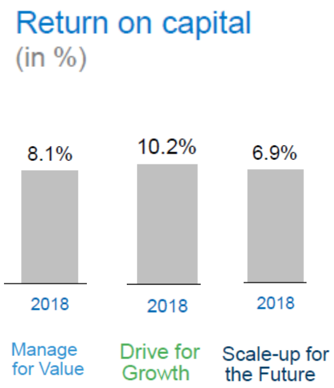
Management and improvement of FCG

- Distinct categories of business
- Focused strategy per category
- Actively manage portfolios
- Develop effective risk & capital management practices

OF (assets) actions	SCR actions	OF (liability) actions	Restructuring
Dividends, Share buybacks	Product mix, M&A	Product mix, M&A, improving efficiency	Organisational restructuring
Debt / Equity issuance, Capital injection	ALM / De-risking/ Rerisking / Reinsurance	ALM / De-risking/ Rerisking / Reinsurance	Sale of entities
Financial Reinsurance	Internal model	Update of parameters, modelling	Sale of portfolios

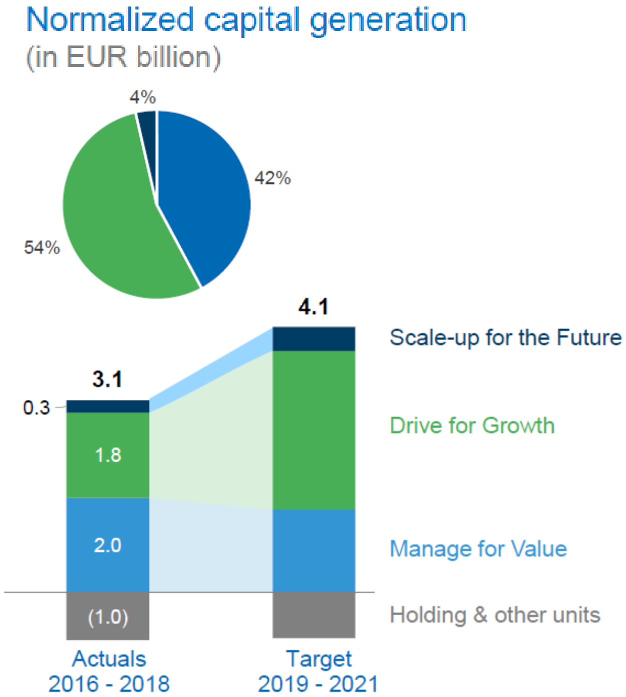
Aegon example (1)

Profitability targets (IFRS)



- Manage both FCG and profitability
- Focused strategy per category of business

Future Cap Gen targets



Source: Aegon analyst presentations

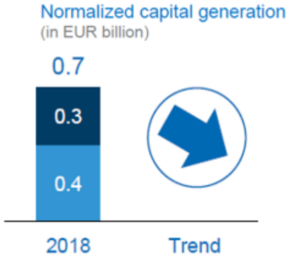
Aegon example (2)

Manage for Value businesses

Americas
- Fixed Annuities
- Stable Value Solutions
- Run-off

Europe
- NL – Life
- UK – Existing business

Asia
- Insights



(1) Continue expense savings
(2) Optimize capital position and accelerate CapGen

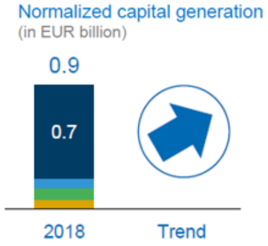
Drive for Growth businesses

Americas
- Life
- Accident & Health
- Retirement Plans
- Variable Annuities

Europe
- UK – Digital Solutions
- CEE[2]

Asset Management

Asia
- HNW



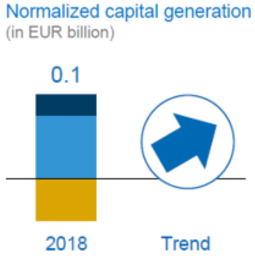
(1) Reinvest in new business while growing Cap Gen
(2) Leverage platform propositions
(3) Benefit from technology investments

Scale-up for the Future businesses

Americas
- Mutual Funds
- Latin America

Europe
- NL – Bank
- NL – Non-life & income protection
- NL – Service business
- Spain & Portugal

Asia
- Joint ventures



(1) Develop new business based on clear and closely tracked criteria

IRR > 10% (country adjusted)
Pay-back period < 10 years
Positive MCVNB

Source: Aegon analyst presentations

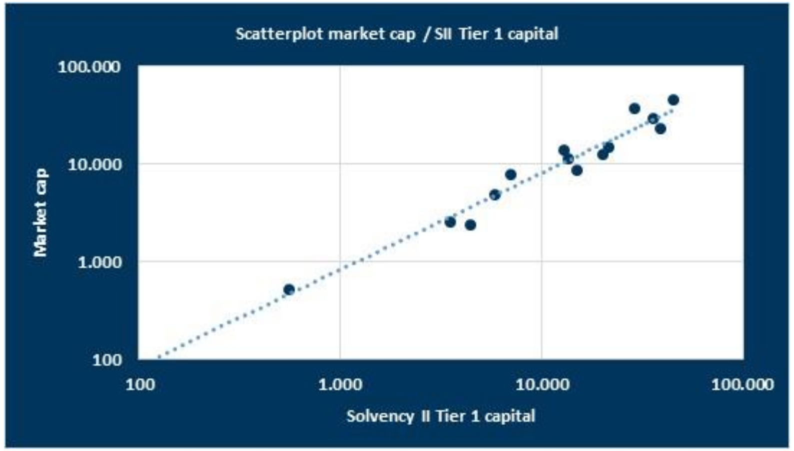
Market multiple analysis (1)

How are life companies valued by investors?

- Market cap strongly related to Solvency II Tier 1 capital.

- We determine the multiples derived from the market capitalization as % from Solvency II Tier 1 capital (unrestricted and restricted) as per FY 2018 and HY 2019.

- Based on an additional high-level analysis we further substantiate observed market multiples.

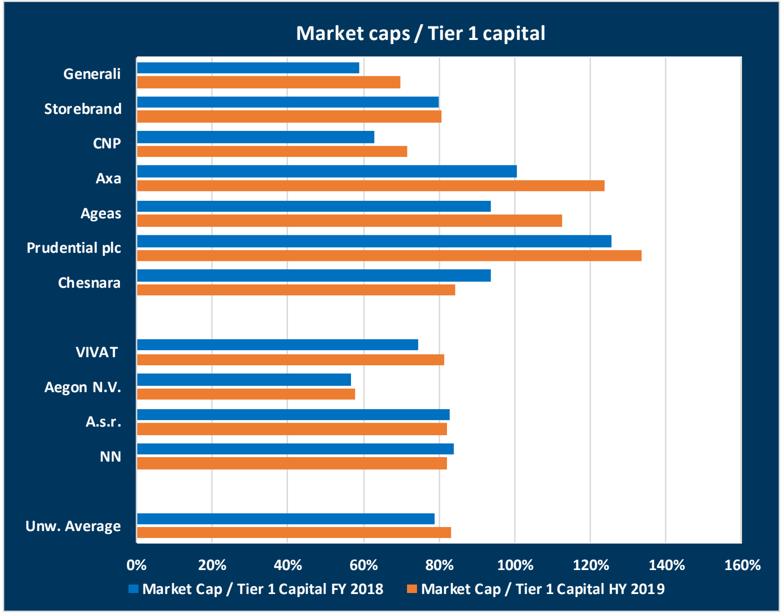


Source: Triple A analysis

Market multiple analysis (2)

Market cap lies on average around 80% of Solvency II Tier 1 capital

- Graph shows multiples derived from the market capitalization as % from Solvency II Tier 1 capital (unrestricted and restricted) as per end FY 2018 and HY 2019.
- Market capitalization per listed insurer depends sentiment on the stock market and could be under- or overvalued.
- Outcomes show large variations among the different insurers, probably also related to underlying differences in type of business, capital structure and accounting treatment.
- We observe that the market multiple on average lies around 80%, with some notable outliers (e.g. Aegon, Axa, Prudential)



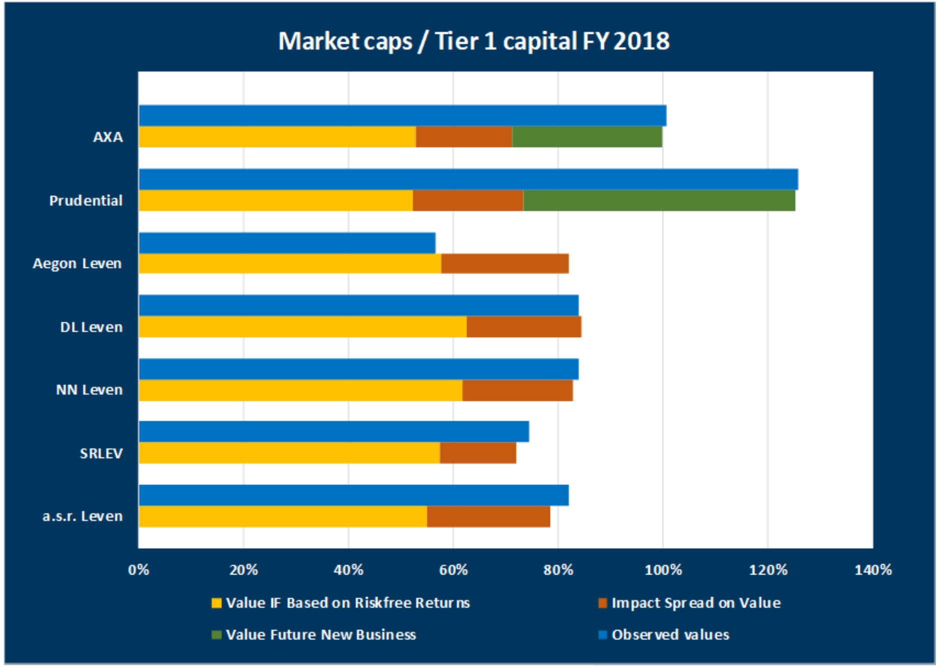
Source: Triple A analysis

Market multiple analysis (3)

Ability to generate positive investment margins and write profitable new business boost company valuation

- Underlying differences in market cap are predicted quite well by breakdown in the following components:

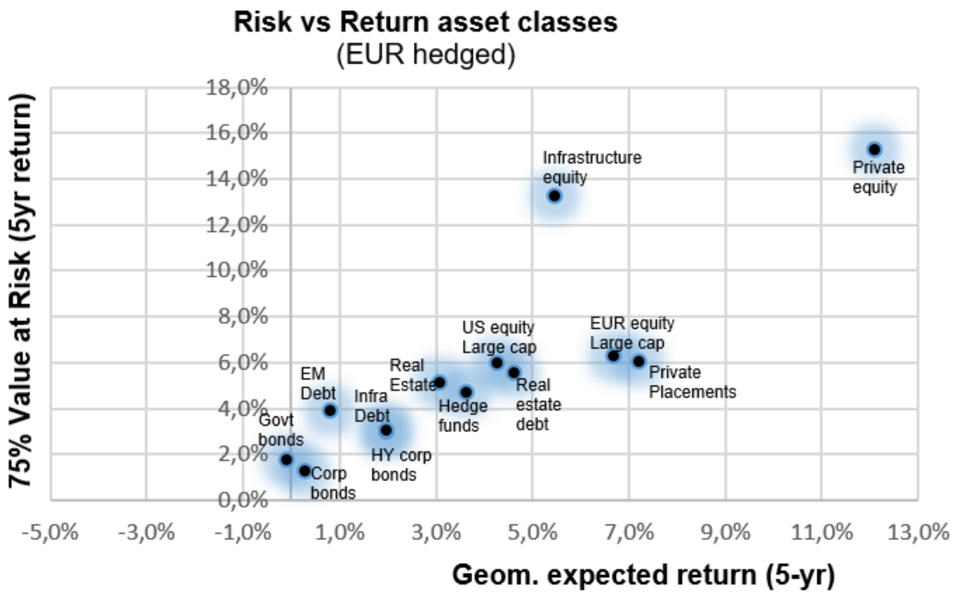
1. ***Value IF based on Risk Free Returns***: value of expected release of Own Funds plus risk margin over time
2. ***Impact Investment margins***: value of excess spread over the risk free rate on own risk assets based on the asset mix
3. ***Value Future New Business:*** The different multiples observed for the global insurance companies in our sample can be explained by the value of future new business: in the Dutch market VNBs are close to zero, whilst for some global life insurers this is not the case.



Source: Triple A analysis

Strong business case to improve FCG through ALM ...

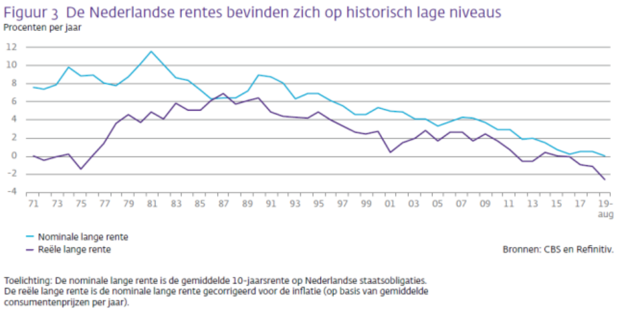
- Extremely high amounts of capital tied in the business of life insurers
- Capital generation under great pressure and limited ways to accelerate capital generation
- Strong focus on improving investment margins and FCG through rerisking and ALM



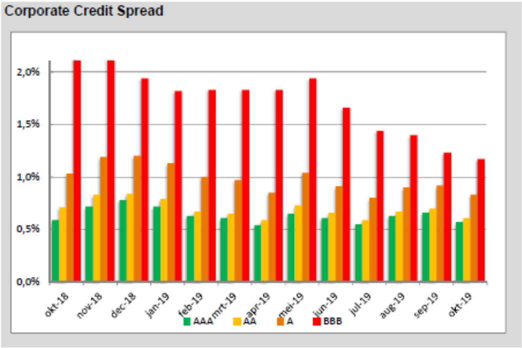
Source: BlackRock Capital Market Assumptions (https://www.blackrock.com)

… it is already happening in NL on large scale

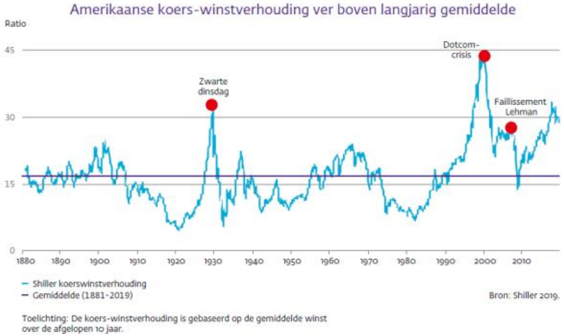
Interest rates

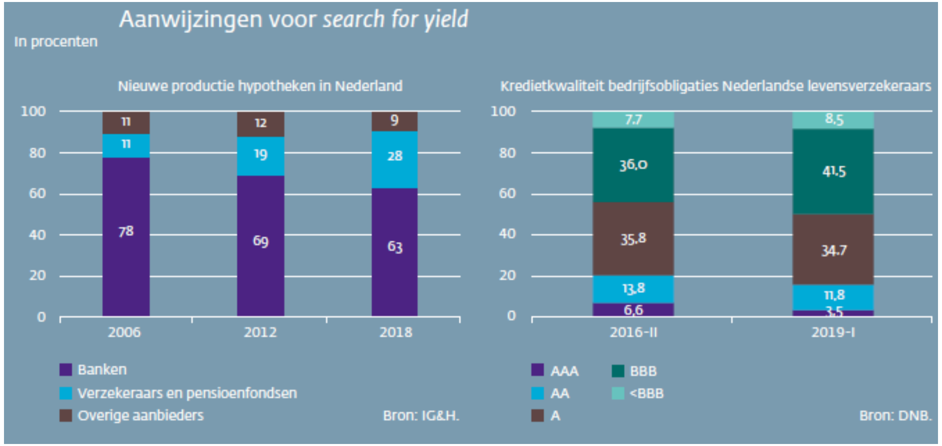


Credit markets



Equity markets



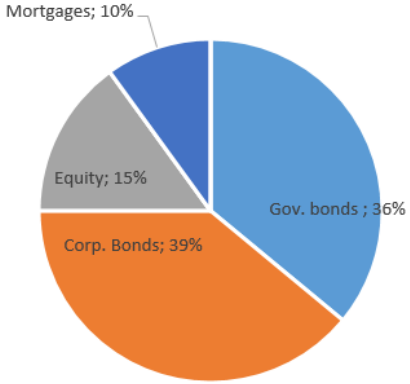


Source: DNB, overzicht financiële stabiliteit, najaar 2019

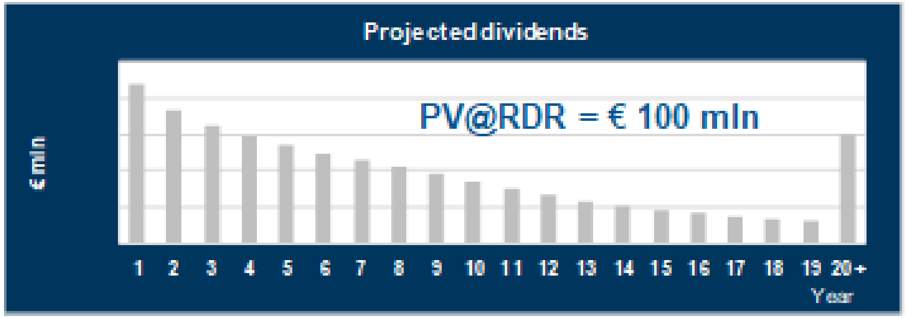
Case study rerisking Dutch life insurer (1)

- Case study: Dutch life company with limited new business
- Around 50% of traditional spread business and around 50% UL/Savings mortgages
- Derived company valuation based on PV of future dividends assuming target capital of 165% of SCR

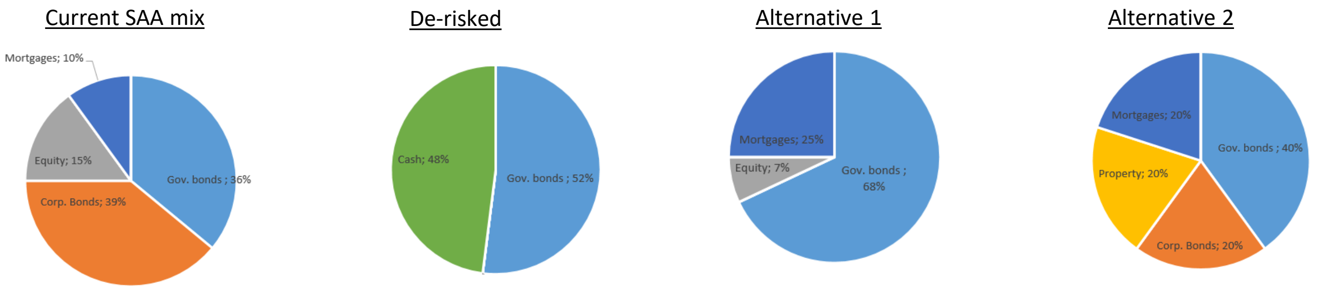
Current SAA mix



PV of future Dividends (or PV of future Net Capital generated at 165% target)



Case study rerisking Dutch life insurer (2)



Asset class	Spread
Gov. bonds	0,1%
Corp. Bonds	0,7%
Equity	4,0%
Property	4,0%
Mortgages	1,4%
Cash	0,0%

	SAA current	De-risked	Alt 1 Rerisking using mortgages	Alt 2 Rerisking optimized
(1) Investment margins	20	0	21	31
(2) Release of capital	51	58	55	53
(3) Release of risk margin	30	30	30	30
PV future dividends (=1+2+3)	**100**	**88**	**105**	**114**
Free capital at time 0	**14**	**29**	**23**	**19**

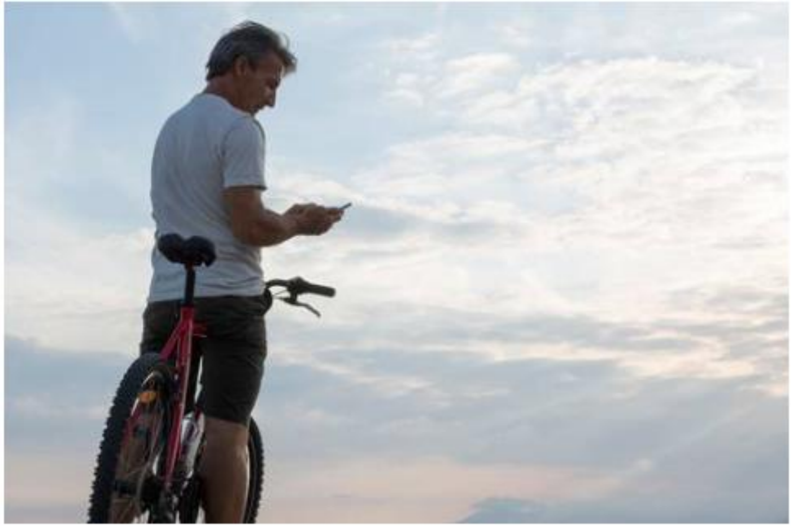
Note: future dividends modelled as future Net Capital Generation using target required capital of 165%xSCR

- Significant improvement of FCG but … take care of "Prudent Person Principle"

Prudent Person Principle: SII Framework Directive article132 -135 | Delegated acts Art 260, 295, 309 | EIOPA L3 Governance GL 27-35

Conclusion

- FCG is a highly relevant framework for investors and other stakeholders
- It will be the leading guide for development of strategy and performance evaluation at European and Dutch insurers
- It is of great importance to gain sufficient insight into how it works and manage the pitfalls



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