DRIVE TRANSFORMATIVE GROWTH

Reinventing the European Life Insurance Industry

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EXECUTIVE SUMMARY

Time to deliver on shareholder value

For the last 20+ years, the European life insurance and pension industry has struggled to generate market growth and shareholder returns. The industry average shareholder returns (since the year 2000) were just 0.8% per annum (p.a.),[1] and assets under management (AUM) only mirror equity market growth. In comparison, other retail sectors such as leisure goods and healthcare provision have outperformed and delivered 7.4% and 4.8% p.a. returns,[2] respectively, over the same period by implementing customer-centric retail business models.

The life insurance industry has not been sufficiently customer-centric and has persisted with existing business models, selling outdated products through traditional channels with very little end-client focus or engagement and a high-cost base. New competitors in wealth and asset management have grown rapidly, capturing the most profitable customers and building lucrative businesses.

However, there is a massive opportunity for insurers to drive transformative growth and new value creation. According to our analysis, the market cap of the European life and pensions industry could **increase by €400 billion over the next five years, more than doubling.**[3] We believe that insurers could be poised for long-term growth by rethinking their core value proposition around solving customer's most pressing problems.

We believe:

- **Insurers are faced with a stark choice of focusing on financial consolidation or customer-centric growth** — both are critical to shareholder returns
- **Traditional life companies should recognise themselves as financial conglomerates,** spanning several businesses with different abilities to support shareholder income and value growth
- **Refocusing on growth, ageing populations and privatisation** can bring huge growth opportunities. Innovation and experimentation are required to build the future propositions that will deliver wins for all stakeholders
- **The European Life Insurance industry should take the lead in transforming the private retirement system.** Insurers have an opportunity to build valuable growth retail businesses anchored around a retirement franchise
- **Activating a CustomerFirst mindset** will drive both short- and long-term value creation. Insurers need to realign corporate strategy with investments that are deeply tied to customers' needs
- **Private equity is a catalyst and force for change both in terms of driving consolidation and iterating and reinventing business models.** The path to a more vibrant future requires significant risk taking and tough choices to pursue

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1 Listed European firms, allowing for reinvestment of dividends. See Exhibit 7 on page 11.

2 Oliver Wyman analysis.

3 Oliver Wyman analysis. Split approximately €100 billion for the Financial Consolidator businesses and €300 billion for Consumer Growth businesses.

In this report, we show how shareholders can drive transformative growth by putting customers first. We set out market insights, industry analysis, and three key operating model changes insurers can take to meet evolving customer needs and drive new business value creation. For those insurers that embrace the challenge — of fortifying both financial consolidation and customer-centric growth businesses — success is dependent on the delivery of simultaneous transformations and a complete reform of their conglomerate structure.

INDUSTRY CHALLENGES

Life insurance companies are conglomerates of very different businesses

Current market caps of mainstream life insurers imply that there is no shareholder value in helping new customers with their protection and retirement needs. To address the causes of this, we first recognise that most life and pensions companies are conglomerates of businesses with very different growth and income generation opportunities. These businesses differ in capital requirements, levers of value creation (see Exhibit 1), and the key operational capabilities required. As a result, they necessitate separate management. It is often difficult for shareholders and analysts to comprehend the value of individual businesses within the conglomerate and how they contribute to the whole. In other sectors, this lack of transparency has been a key contributor to break-up and de-merger transactions.

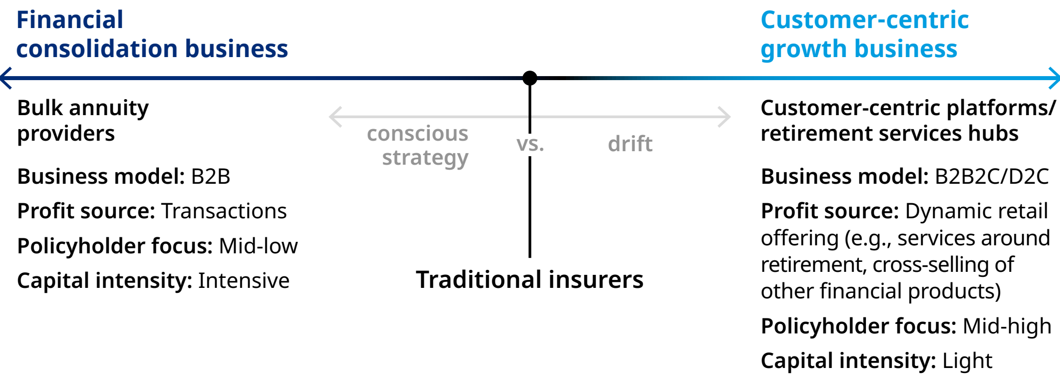
Exhibit 1: The different businesses embedded in a life conglomerate typically fall into two broad categories

	Customer-centric growth business	Financial consolidation business
Commercial purpose	**A customer-centric business:** • Helping mass affluent and mass market customers to prepare for and enjoy retirement • Rapidly growing by capturing the retail retirement opportunity • Dynamically evolving to help clients address their risk and savings issues • Underpinned by a capital-light digital platform	**An in-force financial consolidation business:** • Delivering on existing promises to customers • Delivering shareholder value through a large range of operational, financial and investment levers • Building both scale and the opportunity for further value creation through M&A
Basis of valuation	• Customer-centric growth business • Profitable retail growth	• Distributable income • Transparent dividend generation
Value creation levers	• Potential to achieve valuations similar to a wealth provider or fast-growing retail franchise • Based on revenue and profit multiples • Value enhanced through: - Customer growth - Customer profitability - Retention - Operational excellence	• Valued according to its ability to deliver dividends through the successful management of both the current portfolio and future acquisitions • Based on improving “Solvency II Own Funds” • Higher book to value ratio from: - Strong M&A flow - Efficient transfer to dividend payment - Operational excellence

Source: Oliver Wyman analysis

Most European companies are migrating towards either financial consolidation or customer-centric growth businesses

Exhibit 2: The lack of transparency in the value of individual businesses affects the value of the entire Group



Source: Oliver Wyman analysis

Focus on clients to build long-term shareholder value

The retirement savings and income market presents an opportunity for insurers to build valuable growth businesses, but most have failed in two important ways. First, disruptors, wealth and asset managers and private equity players, have outperformed insurers, capturing most of the new opportunity. Private equity has been a catalyst and force for change both in terms of driving consolidation and iterating and reinventing business models. Second, insurers' propositions are not sufficiently profitable; cost bases have not fallen as fast as margins, and client engagement is limited to product servicing.

In the insurance industry, way too often, we view the marketplace through the lens of our products — "we're in the life insurance business"— rather than through the customer's jobs lens — "I have to care for and protect my family if something happens to me." Too often, innovation focuses on functional improvements to the product but fails to facilitate the real progress consumers are looking for. While this mindset can be widely successful, it fails to deliver on market-creating innovation, which is critical for the industry to unlock growth (and to survive) in the coming decade.

Insurers need to evolve their mindset by shifting away from selling products and moving toward solving problems

Adopting more customer-centric approaches requires insurers to evolve their mindset by shifting away from selling products and moving toward solving problems. And the key to unlocking growth is understanding the customer's highest priority in a specific situation, the **"job to be done."** What does the customer want to accomplish and what problem do they need a solution for? Building services around clients' "jobs to be done" significantly improves the attractiveness of propositions and reduces the marginal cost of delivering them. Other retail and digital industries exemplify how a digitally-enabled proposition with high levels of customer engagement can help constrain costs within even the tightest margins and deliver attractive profits.

Building a truly customer-centric model will require large investments and render much of the existing business processes and infrastructure obsolete. We expect that many companies will fund this transformation by selling off legacy positions. For insurers that choose this disinvestment path, we explore ways to identify the core business model areas to build on, what to sell, and how to optimise value. One key challenge across the industry will be determining the perimeters of transaction opportunities.

Insurers who elect to keep their legacy books will have the advantage of retaining access to the existing clients in these portfolios. However, they will need to vigilantly retain focus on the scale of transformation required and avoid making too many organisational compromises. In addition, they will need to report income and growth businesses separately to clarify where shareholder value originates from. There will be a high burden of proof that transformative change is being delivered.

Radical business model transformation is necessary to profitably capture the retirement growth opportunity

Shareholders are aware of the challenges plaguing the European life and pensions sector, and they are captured in current market valuations. Current market valuations of insurers are low; they are consistent with the existing portfolio and do not incorporate option value for the development of a new customer-centric growth business.

Insurers are faced with a stark choice of focusing on financial consolidation or customer-centric growth — however both are critical to shareholder returns. The upside of success is massive. We estimate the value of existing shareholder equity in the European life and pensions sector could more than double over the next five years.[4] This is equivalent to an additional €400 billion[5] of shareholder value, shared across companies that successfully

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4 For the Financial Consolidator market this is estimated by projecting deal flow over five years in both the closed life and pension risk transfer (PRT) markets and applying current levels of shareholder valuations from both the listed and private markets. For Consumer Growth businesses it has been estimated based on achievable levels of profit growth over the next five years and the current dividend yields PE ratios of the adjacent asset management market.

5 Oliver Wyman analysis. Split approximately €100 billion for the Financial Consolidator businesses and €300 billion for Consumer Growth businesses.

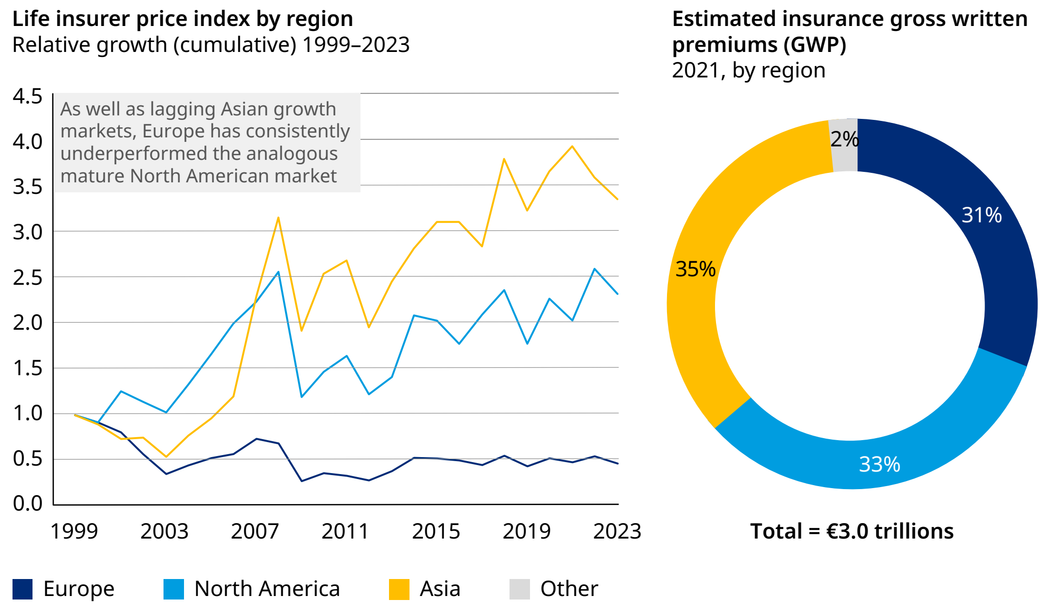
execute the transformation. By thinking and managing in a CustomerFirst way, insurers can reposition themselves as active growth players with an increasing share of customer attention. A successful transformation program needs to work across all levers of change (including leadership, organisation, skill, mindset, and ways of working), and with a view that small steps, systematically taken, lead to big opportunities.

The opportunity — the market cap of the European Life and Pensions industry could increase by €400 billion over the next five years

22 LOST YEARS

In the year 2000, the European life and pensions industry was a highly rated growth sector, with established strengths in medium-term savings and a huge opportunity to capture retirement market growth expected from the privatisation of pension provision. However, recent performance has been poor. Over the last 22 years, the industry has delivered a return worse than just investing in cash, even after allowing for reinvestment of dividends.

Exhibit 3: The European life industry has fallen behind North America and Asia in shareholder value and premium income



Sources: Refinitiv Datastream, Axco, Oliver Wyman analysis.

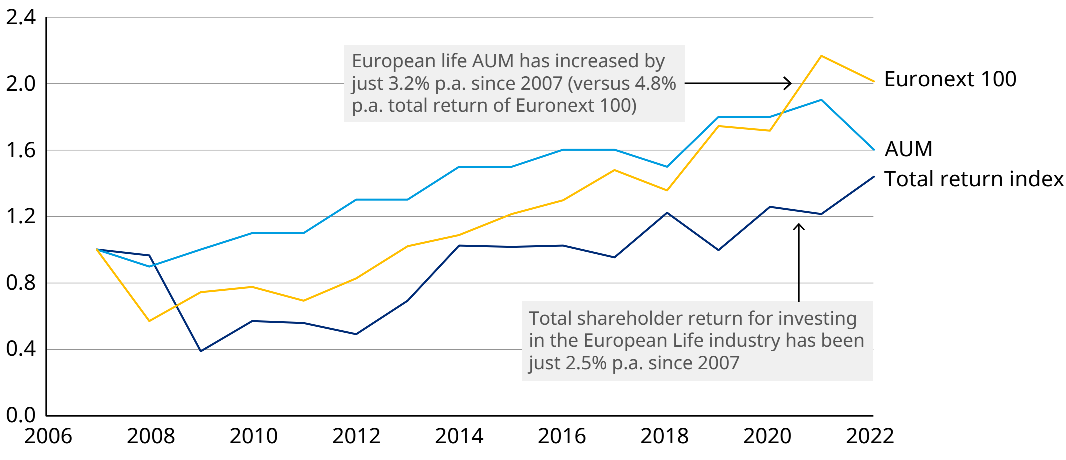
Low growth, and even lower profitability

Over the past 15 years, the industry's assets under management (AUM) across Europe has grown at a slower rate than the total return from the Euronext 100 Index, implying that the industry has not generated real net new money (NNM). Over the same period, shareholder value has remained broadly static after allowing for dividend reinvestment.

Exhibit 4: Shareholder value has been static since 2007 and AUM has mirrored market returns

European life insurer total return index vs. AUM

Relative growth (cumulative) 2007–2022



Sources: Refinitiv Datastream; European Fund and Asset Management Association (EFAMA) — An overview of the asset management industry; Oliver Wyman analysis.

A lack of dividend growth has driven poor ratings

The failure of dividend growth to meet expectations is the primary driver of poor industry ratings. Most life insurers trade at a discount to Solvency II "Own Funds," suggesting that on average shareholders believe the industry devalues the capital deployed. This perception is contagious; even insurers who have managed to deliver strong dividend growth have market capitalisations lower than other sectors. This is a tough starting point for communicating to shareholders the need to invest heavily in a new business model.

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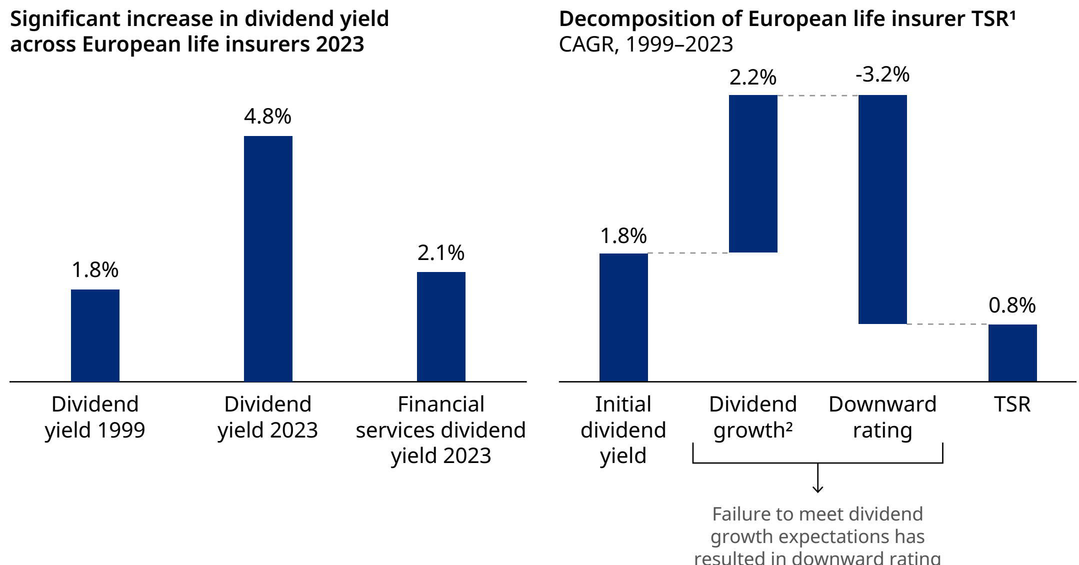
Exhibit 5: The industry has fallen from a growth valuation to an income valuation



1. Total shareholder return is calculated as compound annual growth over an investment in a representative set of life insurance companies held over an investment period from 01 January 1999 until 06 March 2023. Dividends are assumed to be reinvested. Calculations do not account for transaction or reinvestment fees.

2. Calculated using average dividend yield over the period (1999–2023).

Source: Refinitiv Datastream; Oliver Wyman analysis.

LONG-TERM VALUE GROWTH IS ABOUT CUSTOMERS

The insurance industry has focused on capital for many important reasons, including the introduction of Solvency II capital requirements, the volatility of solvency to economic factors, and the capital intensity of legacy portfolios and products. The cost of capital is higher than in most other industries, and much of the innovation effort has been directed towards minimising capital requirements.

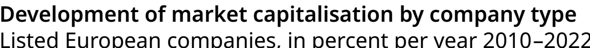
Profitable sales growth is the only sustainable way of building shareholder value

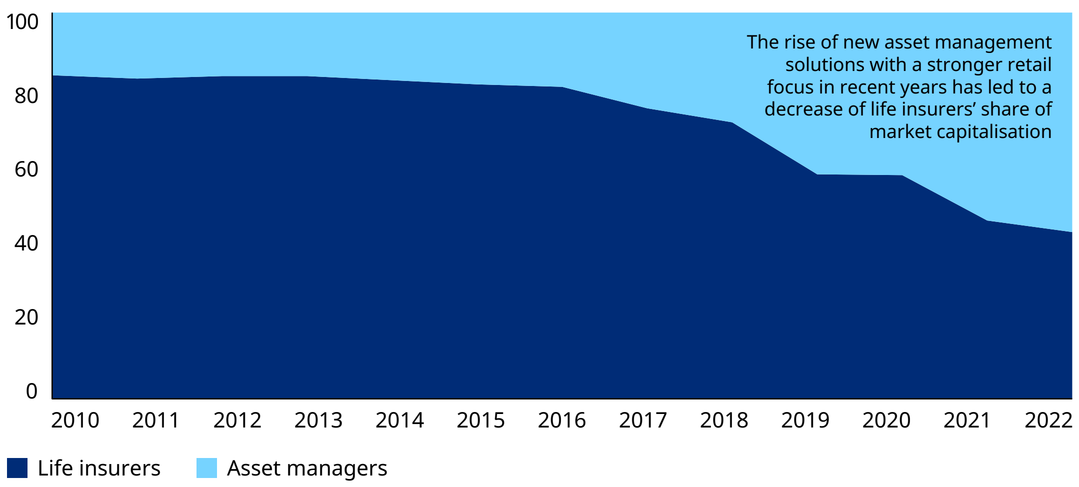
The industry now needs to focus its attention back onto its customers and meeting their changing needs. Long-term shareholder value growth is dependent on selling profitable services to consumers. Insurers have been selling outdated products through traditional channels, with very little end-client focus or engagement, and too high a cost base. The industry's core business lines have declined, segment-by-segment and product-by-product. Additionally, new competitors in wealth and asset management have grown rapidly, capturing the most profitable customers and building lucrative businesses. This has led to a decrease in life insurer's market capitalisation. For example, wealth managers such as AJ Bell and Hargreaves Lansdown have dominated the newly emerging and more profitable individual

segments in the UK, while asset managers and advisory firms are taking the more profitable parts of the corporate pension system. And insurers' share of the life and pensions value chain is declining as intermediaries increasingly opt for open platform solutions and more confident and capable clients choose guided self-selection propositions.

By focusing on customer needs, insurers can identify gaps that, when addressed, create outsized value for customers and shareholders. Insurers need to understand beyond the "what" of customer characteristics (for example, age, demographic, psychographic information) — and get to the **"why" of their customers' motivations** or what the consumer wants to accomplish. Building a truly differentiated solution begins with understanding the full range of customer needs — not only functional, which are often insurers' focus, but also social and emotional.

Exhibit 6: The market cap of the life and pensions industry is declining





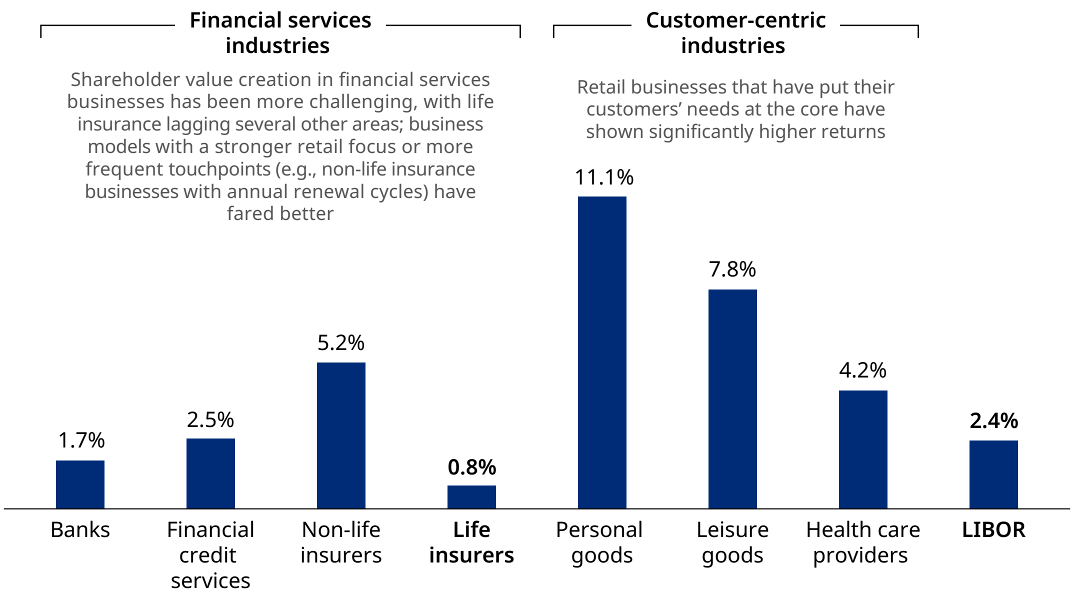
Sources: Refinitiv Datastream; Oliver Wyman analysis.

Other retail industries have been much better at building valuable customer relationships

Compared to other retail sectors selling both financial and non-financial products, European life shareholder returns have been particularly poor.

Life insurers have delivered a lower return than banks over a period encompassing the global financial crisis, massive state investment, and 14 years of quantitative easing. The return is significantly lower than that of non-life and healthcare insurers, which are also businesses that experience similar difficulties in client engagement and have high levels of regulation. The biggest takeaways come from the personal and leisure goods sectors, which have dramatically outperformed the life industry with customer-centric retail business models.

Exhibit 7: Other retail sectors have returned higher value to shareholders than life and pensions



1. Total shareholder return is calculated as compound annual growth over an investment in a representative set of life insurance companies held over an investment period from 01 January 1999 until 06 March 2023. Dividends are assumed to be reinvested. Calculations do not account for transaction or reinvestment fees

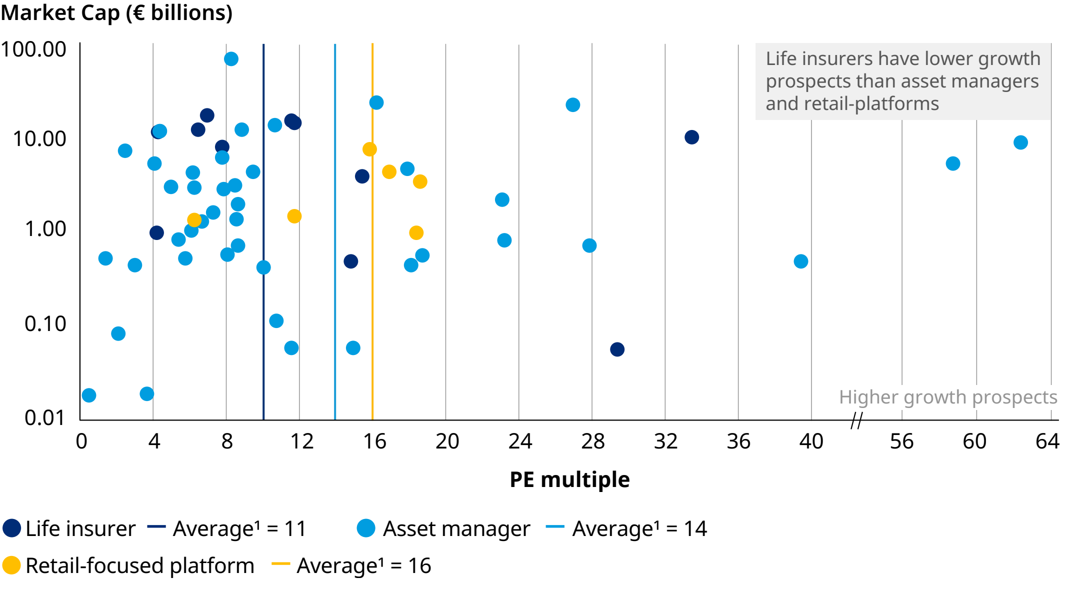
Source: Refinitiv Datastream

Emerging examples of customer-led value creation

Across Europe, life insurers have faced growth challenges with their current business models and are at risk of being rendered obsolete by competition and disruptors. Many of the faster growing investment platform businesses have begun to pivot towards a CustomerFirst approach, which can produce valuation multiples that are generally much higher than traditional businesses. Exhibit 8 below shows that the forward price-to-earnings ratios (P/E) of traditional life insurers are now significantly behind those of asset managers and retail-focused investment platform businesses.

Market values suggest a lack of belief or conviction that insurers can transform to a valuable customer-centric growth model. Strong evidence is needed to award insurers with a re-rating that moves in the direction of other consumer industries. However, even small movements can deliver large shareholder returns, emphasising the value of pivoting to a customer-first approach.

Exhibit 8: 2022 forward price-earnings (PE) multiple for European life insurers and asset managers



1. Market cap weighted average PE multiples
Sources: Refinitiv Datastream, PE multiple is price/next twelve months EPS as at 31 December 2022

Twenty years ago, the European life industry was strongly differentiated from other asset management businesses by its ability to leverage its balance sheet and offer guarantees and innovative products that were attractive to intermediaries. This capability declined as long-term interest rates and margins fell, leaving insurers and asset management specialists with a very similar product set. If the recent interest rate increases are sustained, then insurers will be able to offer differentiating guarantees, but they must not believe this will save their business model. It will certainly provide attractive building blocks for the broader proposition, but the world and insurance consumers have evolved, necessitating a more client-led and product-led approach.

PUT THE CUSTOMER AT THE HEART OF THE BUSINESS

If long-term growth centres around customers, then senior executives should be asking how to realise that growth opportunity. The life industry has very attractive and growing opportunities in retirement savings and income — and this has been true for many years now, but the case for change is much clearer today.

From the top of house, we see frustration at the board level in making new investments that balance the need for clarity on the revenue monetisation path with a longer-term strategy that requires space and discipline to reap returns. The risk-reward equation for new growth is a tightrope. Many “fintechs” have experienced a challenging path to profitability over the past few years, even when heavily adopted and engaged by customers.

Equally, corporates have yet to truly unlock sticky transformations that would create real conditions for success, leaving innovation programs and growth realisation falling flat on their promises.

Insurers and their management teams need to agree on what really matters over the short- and long-term, and acknowledge the journey as a business transformation, not merely a digital one. They need to craft the right portfolio of bets and appropriately allocate the right management attention and resources. Do I have the right balance between business reinvention and growth bets? How do I avoid holding onto initiatives too long, or "dropping them" too soon? In our Oliver Wyman publications, *"Time to start again,"* and *"Think CustomerFirst,"* we showcase how to separate your business portfolio into the **Four Zone** approach. The model enables the kind of focus and executive debate needed to build resilience — the antidote for dealing with disruption. Oliver Wyman collaborated with Geoffrey A. Moore, author of Zone to Win to develop the Four Zone model.[6]

In short, having a clear value creation framework permeates and guides the portfolio of bets in the:

1. Performance Zone (optimising the current business — business-as-usual + initiatives, where growth and margin are the main metrics)
2. Efficiency Zone (make the business more efficient today)
3. Incubation Zone (experiment and pilot initiatives for growth and reinvention)
4. Activation Zone (scaling of growth or reinvention initiatives after having crafted a narrative and built conviction with internal and external stakeholders)

The customer lens — shaping connections to what customers want

The real issue with life insurance and pensions is that they are "end of life" propositions, anchored around preparing for the unforeseeable that marks the worst, but inevitable part of the human experience. Customers are not inclined to think about this experience at a younger age or on a regular basis, or much less establish a meaningful relationship with a company that specializes in life insurance.

Today, the insurance industry overall isn't occupying a relevant enough position in people's financial lives. Insurance consumers have many more choices to fulfill their needs, and they are open to both established and de novo brands that could provide progress. Power has shifted from the supply side, incumbents in well-defined industries, to the demand side, people with problems they seek to solve, to fulfill, driven by time and convenience.

The COVID-19 pandemic has accelerated profitability impacts and industry disruption trends that were playing out pre-crisis. The good news is incumbents are now in a good position to solve customers' most pressing problems and can deliver faster solutions by assembling and absorbing more capabilities from rising fintechs and insurtechs. The low-growth category known as insurance could well be poised for high-growth category reinvention by rethinking the core propositions around customer needs.

6 Inspired by Geoffrey A. Moore, *"Zone to Win,"* with Oliver Wyman collaboration

© Oliver Wyman

So, what do we know about life insurance consumers? They are generally apathetic about financial services products, and money affects their lives both emotionally and socially. How can we leverage this knowledge to unlock growth and market share? How can insurers generate new shareholder value by creating new customer value?

The life industry shares the following client characteristics with other retail industries that are driving shareholder value growth, particularly health and other personal finance sectors:

- Importance of family care and welfare
- Emphasis on enabling the life you want to lead
- A more holistic sense of financial wellness

Jobs To Be Done

What does the customer want to accomplish and what problem do they need a solution for?
Jobs to be done is an approach to market-creating innovation that helps companies uncover opportunities that are systematically overlooked.

Insurers should identify opportunities for supplementing customers' lives with solutions that either address real struggles or replace inadequate options. Building a truly differentiated solution for customers begins with focusing not only on functional dimensions (such as financial terms, accessibility, reliability, performance, and security), but also on the full range of social and emotional dimensions. Accordingly, they must decide how to initiate a conversation around desired progress and how to make it happen.

A job is the progress that an individual seeks in a given circumstance of struggle. We articulate a financial wellness example through the jobs-to-be-done lens in Exhibit 9.

1. **When I am — Circumstances of struggle are the situational context for a job,** the "when and where." While many of the jobs in our lives have adequate solutions, successful innovations resolve circumstances of struggle and trade-offs: they perform jobs that formerly had only inadequate or nonexistent solutions
2. **Help me —** A job generates the **energy required for someone to take an action.** The action can be to start using a new product or service, or develop a cumbersome personal workaround in absence of an adequate solution in the market
3. **So I can — At the heart of a job is the ultimate outcome** or higher order benefit that an individual seeks in a given circumstance

The key to unlocking growth is understanding the customer's highest priority in a specific situation, the "job to be done"[7]

7 As introduced in the book: *"Competing Against Luck: The Story of Innovation and Customer Choice;"* authors, Clayton Christensen, Taddy Hall, Karen Dillon and David Duncan, October 2016.

Exhibit 9: View financial wellness through a jobs to be done lens

The insurer's view

We want to provide customers with more holistic options for financial wellness.

Customers are organised into various segments (life stages, income, and the like) and this is repeated and correlated on the product side (features, and so forth)

The consumer's view

"I'm a wife, mother, and the main provider for my family. I can't stop thinking about the million different financial decisions we need to make in the future. What have I forgotten about? What could go wrong? What would happen if I wasn't here?"

WHEN I AM ...

... contingency planning for if something were to happen to me

HELP ME ...

... agree on what is truly essential versus nice to have

SO I CAN ...

... feel that I am making responsible decisions and prepared for unforeseen events

Why I would "hire" your product or service for my job?

- It ensures my **family** can plan for their financial future
- It **brings us together** today in a way that helps us all prepare for the unknown
- It **reassures me** that we are doing the right thing — and everything I can — to be a good provider and caretaker for my loved ones
- It **helps us make good choices** that benefit us today — before there's a calamity

Source: Oliver Wyman analysis

Customers' "jobs" can be fulfilled in a variety of ways. For some, it involves a broad aspiration (living debt free). For others, it can be goal-oriented (achieving a certain level of care). It can even be rooted in tangential categories (learning how investing works). Progress can be uncovered in categories that seem distant from traditional life and pensions products but are at the core of concern for customers (for example, I want to feel better about my physical health). Opportunity often lies in these unexpected areas.

Capitalise on "key assets" or "crown jewels"

Companies can strategically identify opportunities by considering their "crown jewels," or key assets and capabilities that are unique, valuable, and hard to replicate. This is how companies gain a competitive advantage.

For example, MetLife leveraged the relationship with its core distributor and employers to build a direct connection with its customer base — the employees. This database of connection accelerated the adoption of Upwise, a financial wellness proposition. Babylon Health, on the other hand, realised that people wanted to engage with their symptoms at their own pace and achieved higher engagement with their new symptom chat rather than direct health support. In this case, their broad healthcare knowledge base was the key asset underpinning the solution.

When customers "jobs to be done" are known, and the key assets or crown jewels of your organisation are revealed, you have the ingredients to create relevant, desired and meaningful solutions at scale. Equipped with these things, the following are conditions for growth:

- **Understand that growth is a challenge for CEOs and, at its extreme, existential.** Insurers can establish (or repurpose) a growth transformation office (GTO) to empower the CEO to drive change and include the organisation along the journey
- **Develop a portfolio of bets.** Create a common language around the "four zones to win," yet decouple all the plays. Link your cost and growth investment agendas to fund the future
- **Create new customer value:** What does the customer want to accomplish and what problem do they need a solution for? Focus on the desired experience of struggling customers, and from taking out cost to putting in client value. Unlocking growth is understanding the customer's highest priority in a specific situation, the "job to be done." This guides where to play, how to prioritise, and how to measure success
- **Be Bold:** Make bold decisions to create the conditions for success. The path to a more vibrant future requires significant risk taking and tough choices to pursue

THE CONGLOMERATE CHALLENGE

While building a business that satisfies the needs of evolving retirement customer segments, insurers need to simultaneously manage the in-force book's capital requirements and the impact on dividends. We believe that different pulls from customer-centricity and in-force capital management need to be separated and addressed head on.

Traditional life insurers are conglomerates

Insurers need to move beyond the opaque conglomerate. The traditional life business should be recognised as a financial conglomerate, spanning several businesses with different abilities to support shareholder income and value growth. In general, shareholders find it very difficult to assess the value of a conglomerate and conversely, conglomerates find it difficult to demonstrate their value to shareholders. In some cases, simplifying the structure or reporting will be sufficient, but in most a radical restructuring is required.

Life and pensions businesses are typically managed as one large portfolio, but are actually a complex mixture of businesses with very different characteristics:

- M&A transaction businesses vs. B2B2C and D2C for retail clients
- Capital intensive vs. capital light
- High demand growth vs. mature and run-off
- Asset management vs. risk management
- Intermediated vs. direct
- Explicit fees vs. margin on assets/liabilities vs. profit share

Which businesses do investors prefer? Are they happy to delegate the decision to the conglomerate's management? How important is the overhang of legacy capital problems in overcoming concerns about future dividend growth and sustainability? Large life insurers have hidden opportunities to capitalise on and build strong and valuable growth businesses — they just need to identify them and prove their value to shareholders.

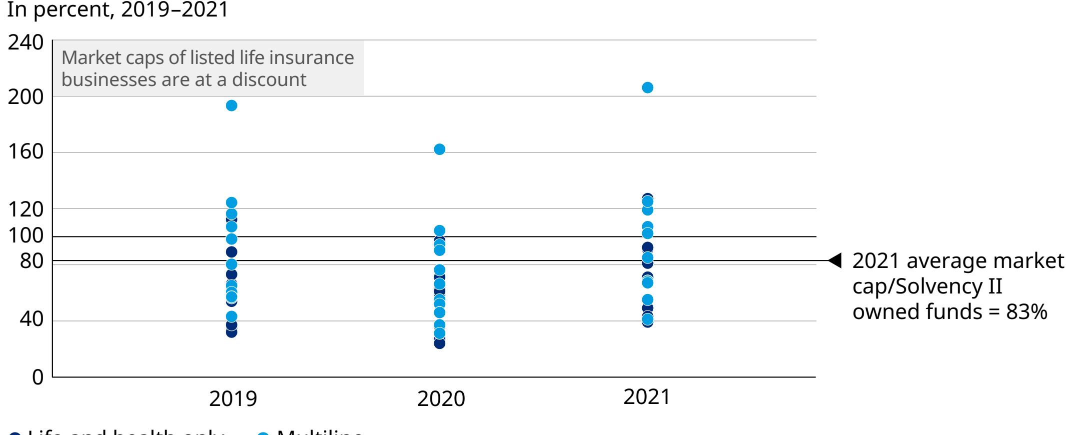
The industry is valued on an income basis

Many life insurers currently have a market capitalisation lower than their Solvency II "Own Funds," as is the case with the prices paid in most life M&A transactions. Therefore, an overwhelming majority of shareholder value can be explained by future cash flows from existing clients and products that have already been sold to them. The option to build a customer-centric growth business contributes very little to share price, and there are many companies actively selling new business with a valuation similar to if they were closed.

At current valuations, the life insurance industry is (on average) valued on an "income" basis, with "growth" business opportunities making a marginal contribution to shareholder value. Unless there is real demonstration of shareholder value creation and growth, this will not change. However, for most insurers, this is difficult to achieve: their focus on capital to manage solvency and the short-term dividend trajectory pushes them towards management of their "income" business. Meanwhile, shareholders do not see or value the growth opportunities, which remain hidden in the conglomerate portfolio.

Exhibit 10: Market capitalisation[1]/Solvency II Own Funds[2] for listed European life insurers

In percent, 2019–2021



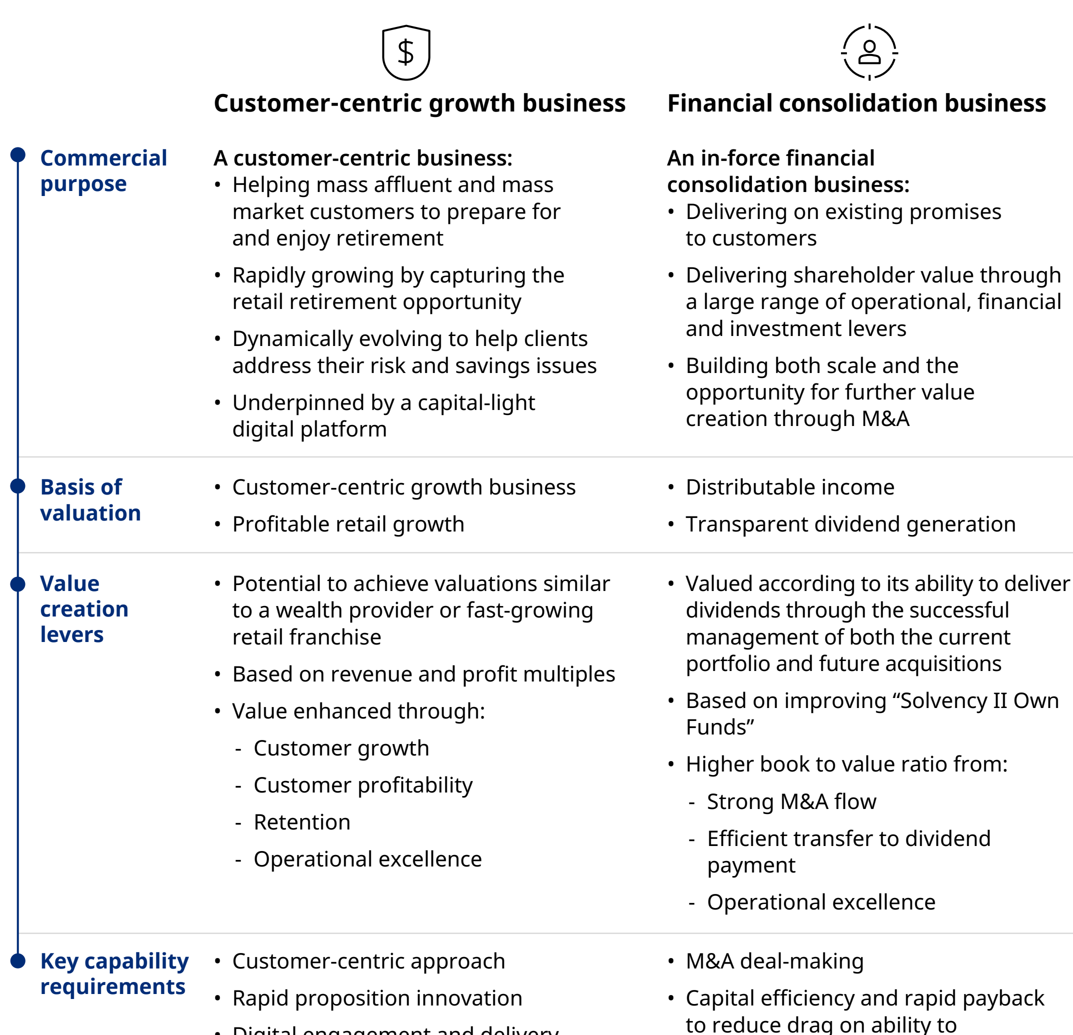
1. End of year values, with the exception of 2021 (= 28 October)
2. 2021 own funds data based on latest publicly available as at 28 October 2021
Source: AM Best, S&P Capital IQ, Refinitiv Datastream, Oliver Wyman analysis

It is difficult to manage a mature, asset-intensive business alongside a high-growth, customer-centric business. It requires a decisive pivot of management, stakeholder conviction, and investment focus towards new value sources, including different organisation structures, investment mechanisms and capital structures — all designed to target business-specific levers of value creation. **The first step is to identify growth businesses across the portfolio and to mobilise and develop them.**

Identify your income and growth businesses

Each business within a life insurance organisation has different operational capabilities as well as different value and risk drivers. These need to be managed separately, reflecting the characteristics of each business model.

Exhibit 11: The different businesses embedded in a life conglomerate typically fall into two broad categories



	Customer-centric growth business	Financial consolidation business
Commercial purpose	**A customer-centric business:** • Helping mass affluent and mass market customers to prepare for and enjoy retirement • Rapidly growing by capturing the retail retirement opportunity • Dynamically evolving to help clients address their risk and savings issues • Underpinned by a capital-light digital platform	**An in-force financial consolidation business:** • Delivering on existing promises to customers • Delivering shareholder value through a large range of operational, financial and investment levers • Building both scale and the opportunity for further value creation through M&A
Basis of valuation	• Customer-centric growth business • Profitable retail growth	• Distributable income • Transparent dividend generation
Value creation levers	• Potential to achieve valuations similar to a wealth provider or fast-growing retail franchise • Based on revenue and profit multiples • Value enhanced through: - Customer growth - Customer profitability - Retention - Operational excellence	• Valued according to its ability to deliver dividends through the successful management of both the current portfolio and future acquisitions • Based on improving “Solvency II Own Funds” • Higher book to value ratio from: - Strong M&A flow - Efficient transfer to dividend payment - Operational excellence
Key capability requirements	• Customer-centric approach • Rapid proposition innovation • Digital engagement and delivery	• M&A deal-making • Capital efficiency and rapid payback to reduce drag on ability to distribute dividends

Source: Oliver Wyman analysis

STRUCTURE AROUND YOUR GROWTH BUSINESS

Is it possible to reform the traditional conglomerate instead of breaking it up?

Managing income and growth businesses within the same group requires coordinated focus. Many life insurers have already reorganised themselves into legacy portfolios and an open business selling to both new and existing customers. This usually does not address the full range of differences in value creation opportunities and risks between the businesses. In our view, providing clarity on both current and future capital requirements alongside growth requires the ability to manage each business as if it were a standalone specialist insurer and to report on them separately to shareholders. It is difficult to explain to shareholders why businesses that should be in "growth" mode are not delivering material profits, or why capital-intensive businesses are not releasing capital to support growing dividends. **Insurers need to be able to see and understand each of these businesses separately and then assess the synergies, diversification benefits, and overheads across the entire group.**

The main challenge with this approach is the scale of change required across the growth and income businesses, which need to be delivered.

Exhibit 12: How to manage consumer and financial consolidation businesses in the same group

Objectives	Key priorities for a reformed conglomerate
Growth business • Deliver new services • Rapidly increase profitable sales • Demonstrate track-record as a disrupter (through building a growth industry)	• In the short term, demonstrate progress in delivering customer-centric propositions • Be prepared to use the balance sheet but only where the customer-centric solution requires it • Strong focus on serving legacy customers to demonstrate the benefit of running both businesses together • In the medium term, demonstrate strong growth across a broad customer market
Income business Manage the legacy book and capital at least as well as a consolidator to support investment in the growth business	• Demonstrate ability to manage capital position so that there is no constraint on planned distribution • Demonstrate the business model is not dependent on a flow of external capital, it must be just an option • Make minimising new business strain an objective • Set payback targets that support dividend plans • As the growth business delivers value, there should be no risk that capital issues will interfere with its planned distribution • In-force business optimisation for operations, investment, cost and funding • Provide shareholders with certainty over dividend distribution policy

Source: Oliver Wyman analysis

FUND THE TRANSFORMATION

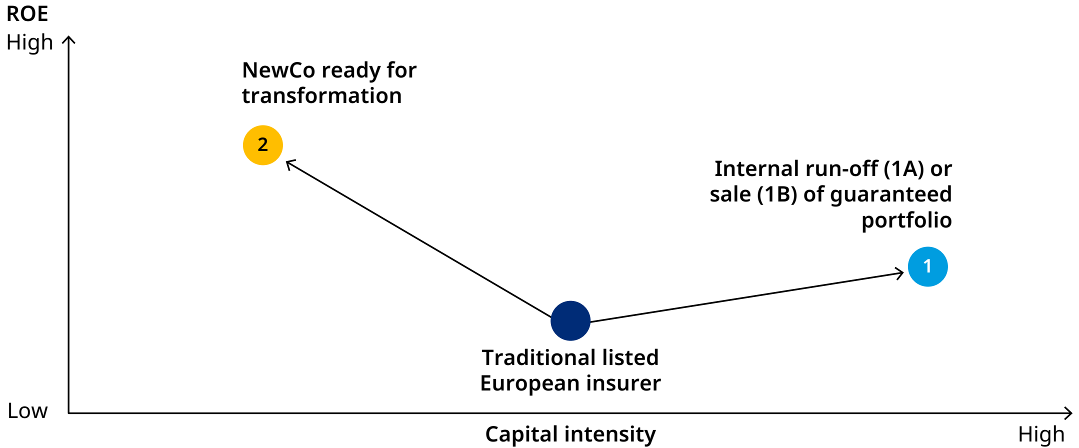
It will be expensive to build new customer-centric businesses that capitalise on the retirement opportunities, and there is not much option value in the share price. This makes it difficult to justify the investment needed to compete with disruptors and investment and wealth providers. However, insurers can derive funding from the disposal of a strategically obsolete portfolios to a consolidator, either through a sale or a funded reinsurance deal.

Fund transformation by selling legacy portfolios

Consider the example of a traditional insurer moving towards a capital-light customer-centric model, with the transformation funded by the sale of a portfolio of capital-intensive guaranteed businesses.

Exhibit 13: Fund the development of new customer-centric growth business

A traditional insurer begins its journey towards a capital light client focused business by using its non-strategic legacy portfolios as source of funds



- Full mix of business, including guaranteed liabilities, protection and unit linked
- Client-centric strategy
- Several guaranteed portfolios identified as non-strategic and valuable to consolidators

1A Internal run-off of guaranteed portfolio

- ROE is similar to sum of the parts
- But internal run-off unit improves ROE through optimising capital, extracting profits and lowering expenses

1B Internal sell of guaranteed portfolio

- Price is similar to the sum of the parts contribution to the seller's market value
- ROE is similar too
- But acquiring consolidator improves ROE through optimising capital and spread generation, and by synergies with other portfolios

2 NewCo ready for transformation

- Strong strategic message and start of strategic transformation
- More about clients, less about capital
- Much lower capital deployment
- Rightsizing dividend

Source: Oliver Wyman analysis

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There are several factors that could pose a barrier to such a sale:

- Portfolio acquirer may expect to pay a significant discount to book
- Loss of some capital diversification benefits
- Potential strains on debt funding of the balance sheet
- Legal structure prevents a sale (for example, for a mutual insurer)

However, at current market capitalisation levels, the amount raised could be similar to the portfolio's sum of the parts contribution to the overall market value. The transaction can still create shareholder value, relative to the alternatives of a rights issue or raising debt. The next question is "what to sell?"

Transaction perimeters — protect the growth opportunity

Many of the insurers selling legacy portfolios in Europe have found it relatively easy to decide what to sell based on their strategic focus, for example:

- Many international insurers are deciding which markets are core and selling off the rest
- Others are taking a more "lines of business view," retrenching from life business or focusing on protection or health. Some are slimming down and selling off non-core businesses
- Many are switching away from guaranteed books to capital light propositions. Recent increases in long-term interest rates may have increased the value of some guaranteed portfolios (dependent on the insurer's own circumstances, especially the hedging position)

However, an increasing proportion of portfolio sales originate from insurers who have key strategic growth business and legacy portfolios that are entangled and difficult to separate, for example:

- Insurers that are refocusing on unit-linked businesses and selling off legacy portfolios, while maintaining the same distribution channels and target client segments
- Insurers that are selling off specific capital-intensive portfolios which might share operational capabilities with their ongoing strategic business

In these cases, the transaction perimeter must protect the value of the future growth opportunity and identify a valuable portfolio sales opportunity, all while ensuring that the separation is efficient.

Exhibit 14: Preparation for transaction

Key separation criteria	Example issues	Preparation activities
Strategic clients	• Are there clients in the legacy business that are still core to the growth business?	• Core client research on growth proposition • Marketing rights definitions
Strategic channels	• Are there shared channel use and therefore related commission arrangements? • Any potential risk to key strategic distributors?	• Strategy for managing potential risks • Engagement and commitments to key distributers
Strategic products	• Any legacy product capabilities still useful in the growth business? (For example, protection) • Any growth propositions useful in the legacy business? (For example, post retirement platforms)	• Distribution agreements • Service level agreements
Operational	• Regulated entity versus portfolio transaction • Systems shared by both businesses: ownership and update • Organisation and governance • Legal and regulatory	• Management structure • Legal structure • Regulatory structure • Operational separation review • Contract design and clarity on servicing
Financial	• Minimise loss of capital diversification benefits • Minimise capital intensity of the future customer-centric growth business	• Capital review across both businesses • Funding for ongoing growth business • Reporting structures and management information
Attractiveness to consolidators	• In general, fixed and guaranteed liabilities are most attractive to those consolidators who have a spread based strategy	• Portfolio review to optimise potential sale value • Sales strategy

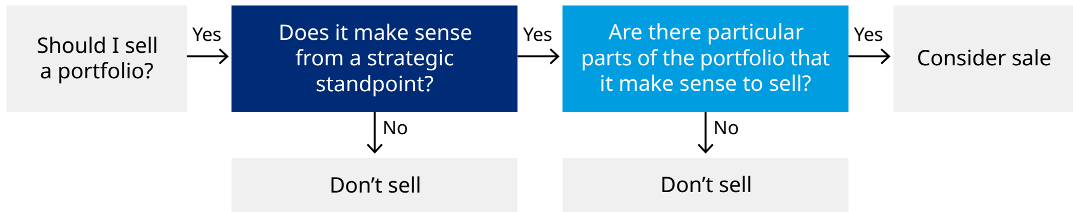
Source: Oliver Wyman analysis

Pragmatic solutions are necessary for other parts of the portfolio that no longer fit into either business model. There may be specific business lines that are not part of the growth business and are also not attractive to consolidators (for example, services that can best be provided on an outsourced, third-party basis).

Beginning the transformation

Consider the scenario where a German business, or German subsidiary of a wider European insurance group wants to transform — to focus on retail consumer growth and achieve higher profit growth and higher return on equity (ROE). The design of the new business model includes a review of historic portfolios that do not contribute to the new strategy and have low ROEs.

Exhibit 15: "Selling the traditional business" Trading off financial, legal, systems and strategic requirements



Does it make sense from a strategic standpoint?

Key questions to consider	Oliver Wyman perspective
How well-capitalised is the company as a whole?	A low Solvency II ratio may incentivise sales but would also affect value
Is the portfolio a core life business?	Non-core life business is more attractive for sale than a portfolio that is key to business operations and objectives
How profitable is the portfolio?	A low return on capital may make a portfolio more attractive to sell
How old and in what shape is the policy administration system (PAS) for the portfolio?	Is the policy administrative system (PAS) close to the end-of-life? If yes, it may be better to leave the replacement to a new owner
Is the portfolio generating new business?	Portfolios not actively issuing policies (for example, run-off and legacy portfolios) may be more attractive to sell
How is the portfolio's market share changing?	A declining market share (or low prospects for future increases) may make a sale more attractive
What is the company's ownership structure?	Proprietary companies or consolidators may find selling portfolios easier than mutuals

Defining the perimeters of the transaction

Key questions to consider

Which parts (products) from the portfolio hurt the most in terms of impact on capital consumption and/or profitability?

Is the portfolio/part of the portfolio legally separate or can it be carved out?

Is the portfolio/part of the portfolio on its own IT-system or individual systems?

Do any relevant conflicts exist regarding that portfolio, for example, related to:

- Customers
- Distribution, in particular brokers
- Carriage of cost for the overall entity

Case study
European insurer

- Portfolio for sale mainly comprised products with high capital consumption
- The portfolio was not legally separate, but it could be carved out
- The products were on several distinct IT-systems

Only a minor part of strategic and profitable unit-linked and protection products was required to be exempted and moved before carve-out

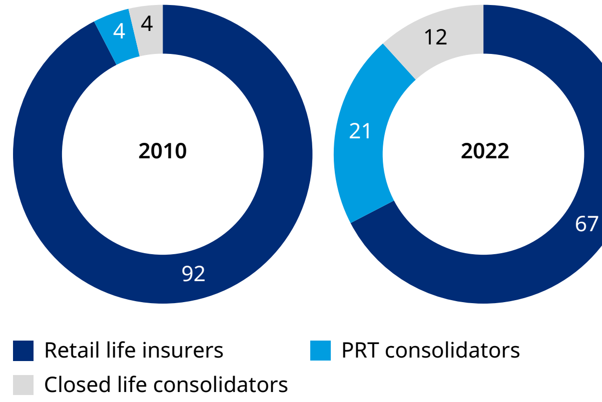
Source: Oliver Wyman analysis

Strong continuing transaction demand from consolidators

Consolidator demand for acquiring legacy portfolios is robust in both the UK and US markets and has been rapidly growing across Europe over the past five years. Their core purpose is to manage legacy portfolios for value, using a variety of M&A, investment, operational and financial levers, based on the rationale that they can accomplish value creation better than incumbent insurers. They typically achieve long-term returns in the mid-teens (% p.a.) for their private and capital investors, and now account for around one-third of the shareholder value in the European life and pensions markets.[8]

Exhibit 16: Growth of Financial Consolidators

Estimated split of shareholder value by company type[1]
Europe, €BN and percent



Observations and implications

In absolute terms, European life value has increased slowly vs the wider market (see Exhibit 4)

However, the share of total sector shareholder value across both listed and private businesses has shifted strongly towards consolidators

- Operating in closed-life consolidation
- In pension risk transfer

The current market valuation of most listed businesses can be explained by the value of their business already in force — with little value being created by new sales

1. Including estimated values of non-listed companies. Listed company data as at 31 December 2010 and 31 December 2022
Source: Refinitiv Datastream, S&P Capital IQ, Oliver Wyman research and analysis

Consolidators will continue to search for more deals. Typically, their profits from new transactions are realised in the first few years after acquisition, as they deliver improved capital management, cost control, asset spread and other operational improvements. This means that Solvency II "Own Funds" generation can quickly increase in the period after acquisition, typically over 20% p.a., before dropping back to much lower levels after the main value creation opportunities have been mined-out. The associated transition costs and consolidation activities also occur in the same timeframe. An important consequence is that consolidators require a steady flow of new deal opportunities to maintain their shareholder return and operations.

Therefore, we have seen the industry squeezed on two fronts: First, by new competitors in the formerly core savings market who are better able to meet client's needs and expectations, and second, by specialist back-book consolidators who are able to deliver better financial returns from their legacy portfolios.

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8 Includes both listed and private shareholder funds, includes legacy life portfolios and bulk annuity sales to defined benefit (DB) pension schemes.

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CONCLUSION

European life and pensions conglomerates have a stark choice between reinventing themselves as customer-centric growth businesses or drifting into becoming a manager of legacy run-off portfolios. Many European companies are migrating towards either financial consolidation or customer-centric growth businesses — however both are critical to shareholder returns. Customer-centric disruption is already well established in many segments of the retirement sector and will soon make rapid headway in the mass affluent markets. We believe the market cap of the European Life and Pensions industry could increase by €400 billion over the next five years, more than doubling[9] — and will be dominated by firms that put customers first.

Insurance consumers have many more choices to fulfill their needs, and they are open to both established and de novo brands that represent progress. Power has shifted from the supply side, incumbents in well-defined industries, to the demand side, people with problems they seek to solve, to fulfill, driven by time and convenience. To drive both short- and long-term value creation, insurers need to deepen relationships with customers, activate a CustomerFirst mindset, and realign corporate strategy with investments that are deeply tied to customers' needs.

Insurers need to identify channels that supplement customers' lives with solutions that either address real struggles or replace inadequate options. Building a truly differentiated solution for customers begins with focusing not only on functional dimensions (such as financial terms, accessibility, reliability, performance, and security), but also on the full range of social and emotional dimensions.

By thinking and managing in a CustomerFirst way, insurers can reposition themselves as active growth players with an increasing share of customer attention. A successful transformation program needs to work across all levers of change (including leadership, organisation, skill, mindset, and ways of working), and with a view that small steps, systematically taken, lead to big opportunities.

At Oliver Wyman, we have been helping clients to activate a CustomerFirst mindset and invoke key operating model changes to drive transformative growth. We can support your team with structuring large scale transformation programs and building new value creation — both through building new customer-centric models and by structuring portfolio transactions.

The time to get started is now.

9 Oliver Wyman analysis. Split approximately €100 billion for the Financial Consolidator businesses and €300 billion for Consumer Growth businesses.

Oliver Wyman is a global leader in management consulting. With offices in more than 70 cities across 30 countries, Oliver Wyman combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation. The firm has more than 6,000 professionals around the world who work with clients to optimise their business, improve their operations and risk profile, and accelerate their organisational performance to seize the most attractive opportunities.

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