



The EY Life Insurance Index
1st quarter 2016

Executive Summary

Life insurance confidence recovers marginally

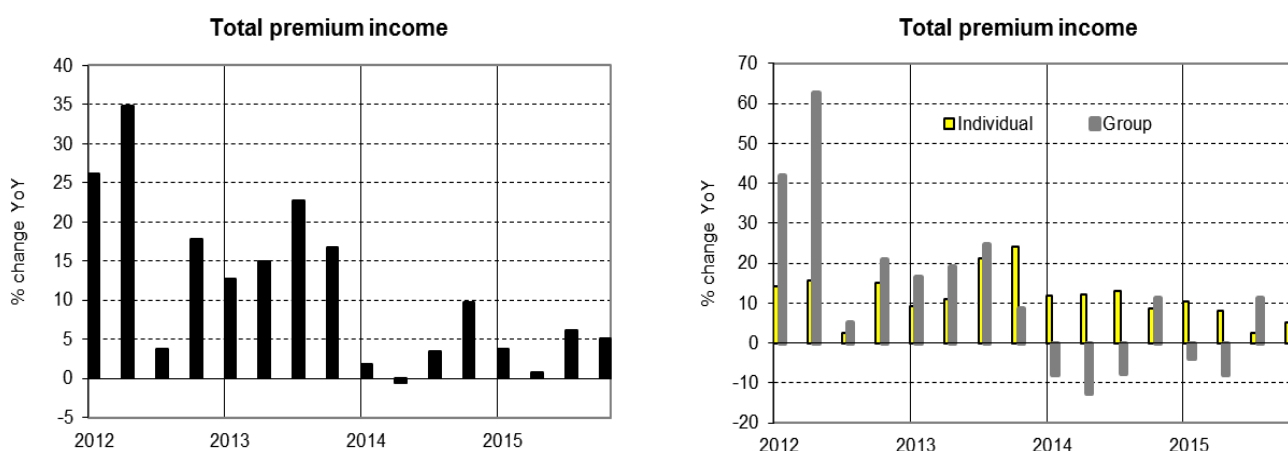
- ▶ According to the BER's survey, growth in premium income was minimal in 16Q1.
- ▶ Premium income from both risk and investment business contracted again, even more so than in 15Q4.
- ▶ Continued declines in new business premiums and rising lapses lead to a weak premium income outlook.
- ▶ After moving broadly sideways during 2015, growth in investment income fell in 16Q1.
- ▶ Growth in administrative and marketing expenses edged lower during 16Q1.
- ▶ In 16Q1, net profits after tax increased in line with 15Q4 levels.

Life insurance

Slow economic growth and weak investor confidence in emerging markets across the globe has resulted in a slowdown for life insurers from both their main revenue earnings streams, namely premium income and investment earnings. With equity markets falling across most of the globe, and asset prices weakening, this has inevitably slowed investment income growth. Added to that, weak economic growth has seen a considerable slowdown in both corporate and individual premiums.

Life insurer confidence increased from 74 index points in 15Q4 to 79 in 16Q1, with life insurers returning to being the most confident of all financial services segments (this after investment banker confidence fell sharply in the first quarter). Life insurers are only marginally below their long-term average confidence level (82). The stronger confidence is in line with marginally stronger profits growth, and a sharp recovery in new business value.

By historical measures, confidence levels are weak, although much stronger than the other financial services segments. According to data from the SA Reserve Bank's March 2016 *Quarterly Bulletin*, slow growth in premiums is ascribed to both weak group and individual premiums (see the charts below).



According to the BER's survey, there was close to zero growth in premiums in 16Q1, with both risk and investment business contracting, albeit at an improved pace since 15Q4.

Continued declining new business premiums, coupled with rising lapses do not bode well for future premium income flows. With the exception of the High Net Worth segment of the retail market, strong pressures are impacting household finances, with rising prices and higher interest rates, coupled with limited job prospects all playing a role.

After moving broadly sideways during 2015, investment income growth shrank sharply in 16Q1.

Benefit pay-outs picked up noticeably in the third quarter and further in the fourth quarter of 2015 after a long period of sedate growth between the middle of 2013 and the middle of 2015. Pay-outs slowed noticeably in 16Q1, but respondents expect a rebound in 16Q2.

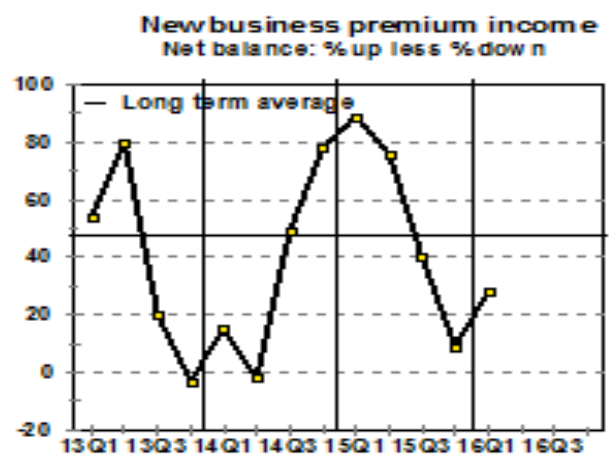
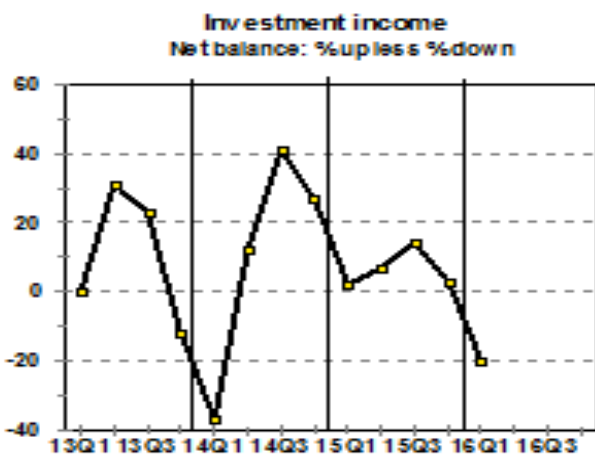
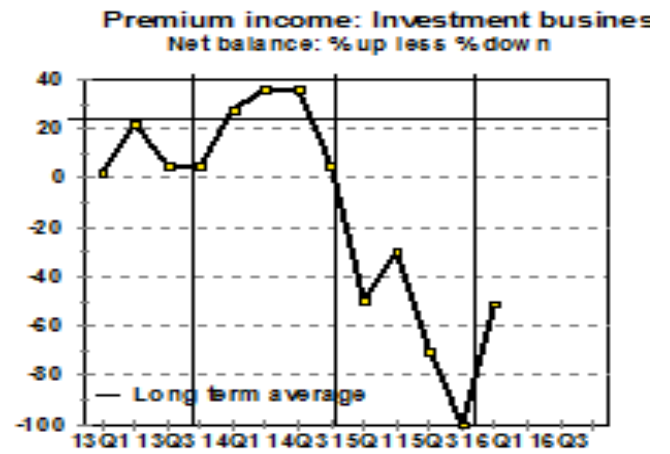
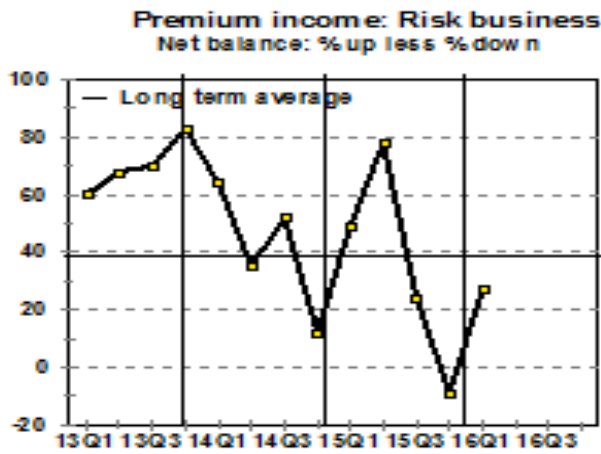
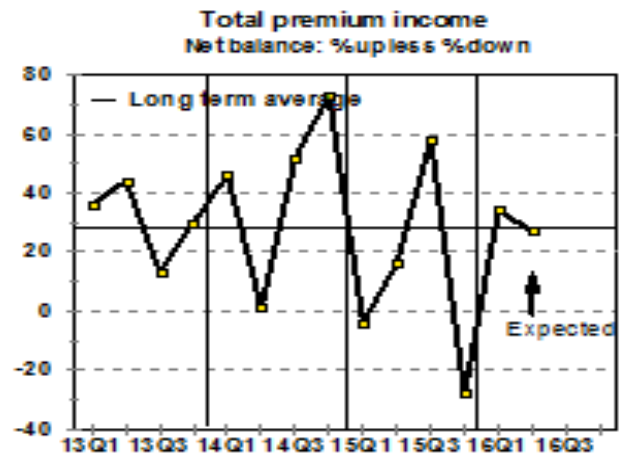
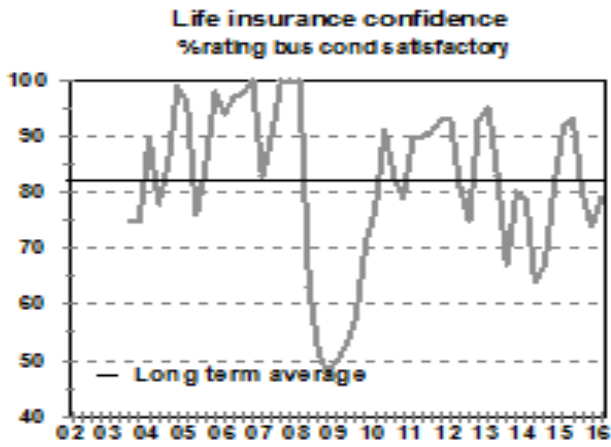
Life insurers reported lower administrative and marketing expenses growth in 16Q1. Lower costs were in line with considerably lower headcount numbers, with both the sales force and administrative employee numbers declining. Life insurers have been cutting back on the administrative headcount for a full year now, whilst the first quarter was the first to see sales force numbers shrinking.

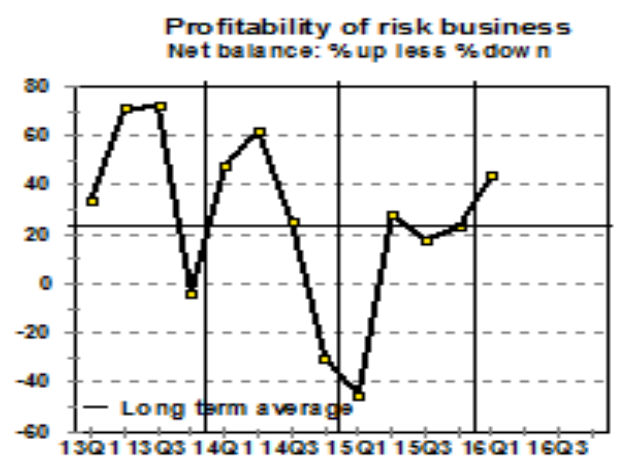
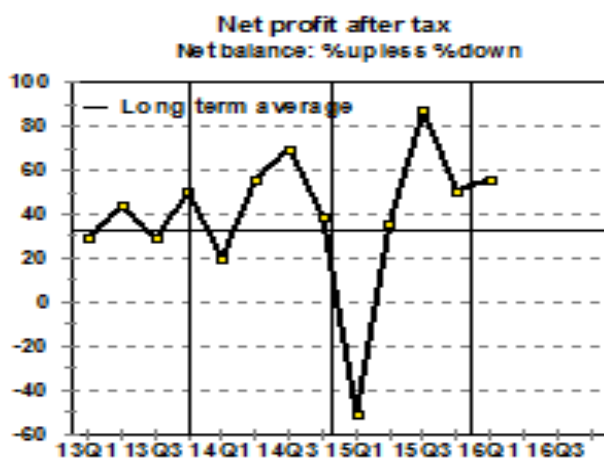
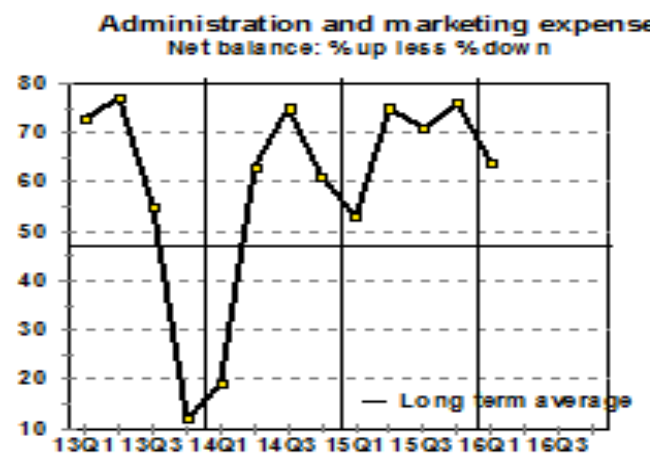
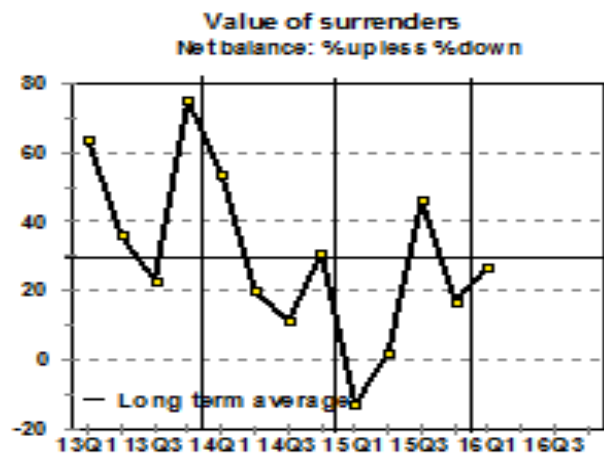
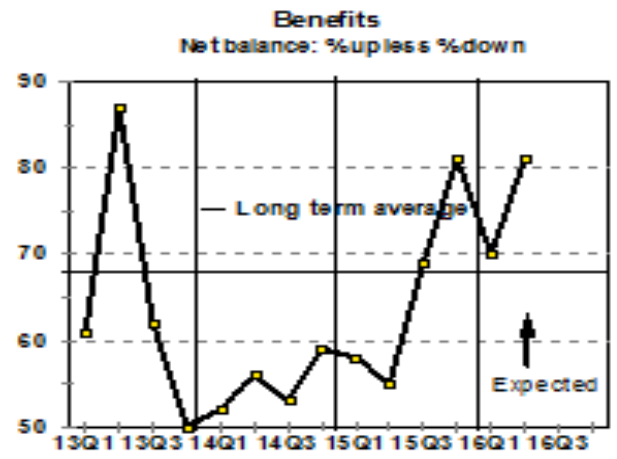
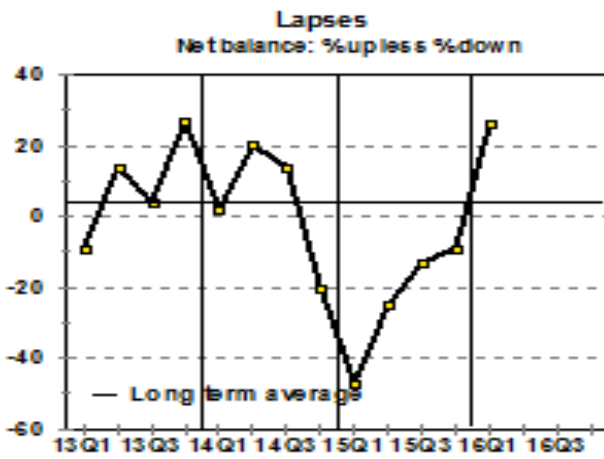
Net profits after tax increased again in the quarter, in line with 15Q4 levels.

Survey data: Life Insurance ¹	2014		2015				2016	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2*
1. Business confidence ²	67	81	92	93	80	74	79	
2. Inflow								
a) total inflow ^{3,4}	50	64	-3	14	49	-22	23	
b) total premium income ^{3,5}	52	73	-4	16	58	-28	34	27
i) risk business / no of new contracts ³	52	12	49	78	24	-9	27	
ii) investment business (only individual business) ³	36	5	-50	-30	-70	-100	-51	
c) new business premium income ³	49	78	89	76	40	9	28	
d) lapses / no of contracts terminated ³	14	-20	-47	-25	-13	-9	26	
e) investment income ^{3,6}	41	27	2	7	14	3	-20	
3. Outflow								
a) total outflow ^{3,7}	55	59	58	57	69	81	69	
b) benefits ³	53	59	58	55	69	81	70	81
c) value of surrenders ³	11	31	-13	2	46	17	27	
d) sales remuneration ^{3,8}	89	53	68	80	72	57	64	
e) administration and marketing expenses ³	75	61	53	75	71	76	64	
f) number of full-time admin employees ^{3,9}	41	53	14	-2	-7	-2	-18	
g) number of in-house agents ³	33	-27	51	57	31	56	-13	
4. Profitability								
a) net profit after tax ³	70	39	-51	36	87	51	56	
b) profitability of risk business ³	25	-30	-45	28	18	23	44	
c) administration expenses as % of premium income ³	24	-10	69	41	16	61	38	
d) value of new business ³	33	32	28	29	16	-54	42	

* Expected

1. Individual life and retirement annuities business plus group life and employee benefit business.
2. % satisfactory, weighted according to firm size
3. Net balance (see Technical Note at the end of the report), weighted according to firm size
4. Weighted net balance (80% total premium income + 20% investment income)
5. The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply "the same" given that the net balance statistic does not take "the same" responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.
6. "Investment income" refers to all income from investments and not the investment return. It includes dividend, interest, rental and other non-capital investment income, as well as realised and unrealised capital gains and losses on investments.
7. Weighted net balance (90% benefits + 10% administration and marketing expenses)
8. Distribution costs and commissions.
9. Excluding field staff





Technical note

A document with more information on the survey method is available on www.ber.ac.za. Click the button named "Services" and then select "Surveys" and finally "Financial Services". Alternatively, click on "EY Financial Survey" on the home page and then on "Financial Services" under Quick Links.

Survey method

The BER started conducting surveys amongst retail and investment banks in 2002. The scope of the survey was expanded to asset managers and life insurers in 2003.

EY, the international accounting and business advisory firm, not only supports the financial sector survey financially, but also made valuable inputs to the design and makes the overall results public. However, the BER conducts the survey and interprets the results. The BER treats the identities of participants and individual responses as confidential and does not reveal this information to any third party, including the sponsoring firm.

The division heads of all the major retail banks, investment banks, asset managers and life insurers operating in South Africa participate in the survey.

The survey results reveal current and expected changes in income, expenses and profitability for these firms' South Africa operations only. Industry specific issues, such as banks' credit standards and the demand for various products of asset managers, are covered during the first and third quarter surveys.

The surveys are conducted during March, June, September and December. The results reflect developments per calendar quarter, i.e. the first quarter reflect developments during January, February and March; the second quarter reflects April, May and June etc.

On occasion questionnaires reach us after the date on which the results of the current quarter are processed. Small revisions of the survey results of the previous quarter could occur when we process such questionnaires at a later stage.

The need for the financial sector survey

South Africa has one of the most advanced financial sectors of all emerging market economies and its development is in many respects on par with those of industrialised countries - and yet its performance is not measured regularly and consistently. There is a general consensus on the need for a regular, consistent and impartial financial services survey, from managers in the financial sector to financial analysts.

The contribution of the financial sector to GDP has increased over the past decade and stood at 9.7% during 2011. The contribution of - for example - real estate (6.0%), transport (6.6%) and retail trade (7.2%) are all lower compared to that of the financial sector. However, the general government (16.5%), manufacturing (12.8%) and mining (10.2%) are bigger.

Despite its importance, current information on the performance of the financial sector lags behind:

- ▶ Statistics SA publishes GDP and employment figures for the sector covering financial intermediation, insurance, real estate and business services with a lag of one quarter and no details about the sector's financial performance.
- ▶ The compulsory monthly BA 120 (DI 200 until 2007) returns of banks to and the Annual Report of the Bank Supervision Department of the Reserve Bank, the Quarterly Financial Stability Review of the Financial Stability Department of the Reserve Bank and the Annual Report of the Financial Services Board (FSB) provide detailed information about the performance of banks and other financial institutions, but the information is made public with a lag in time except for the BA 120 returns.
- ▶ The interim and annual reports of listed financial companies provide information about their performance, but these reports appear at irregular intervals (their release dates depend on the financial year-ends of the different companies) and the results are not always comparable.
- ▶ The periodic Price Waterhouse Coopers (PWC) Survey, although entirely relevant in relation to its intended target market and ultimate aim, differs fundamentally from the EY financial services survey. The EY survey measures the same performance criteria of financial institutions over time, appears quarterly and the results are obtained by means of short questionnaires.

- ▶ The quarterly unit trust and bi-annual life insurance reviews of the Association for Savings and Investment SA (ASISA) are useful. However, the unit trust review does not provide information on the financial performance of management companies and the life insurance review is only published twice a year.
- ▶ The investment performance and strategy of asset managers are measured regularly (e.g. Alexander Forbes and Plexus), but no regular, consistent measure of income and expenditure of asset managers exist.

The international standing of the financial sector survey

The UK, Poland and Switzerland have the longest experience in conducting financial services surveys. In the UK, the Confederation of British Industries (CBI) in London has been conducting comprehensive quarterly financial services surveys in partnership with Price Waterhouse Coopers (PWC) since December 1989. In Poland, the Research Institute for Economic Development (RIED) at the Warsaw School of Economics has been conducting a banking survey since 1999. The Swiss Business Cycle Institute (KOF) in Zurich has been conducting a quarterly banking and insurance survey since the beginning of 2000.

In the USA, the Federal Reserve Bank has been conducting a “Senior Loan Officer Opinion Survey on Bank Lending Practices” for many years, but unlike the UK, Polish and Swiss banking surveys, it focuses on bank lending practices and not the financial performance of the bank sector.

The South African financial services survey is modelled on those of the UK and Switzerland. However, the questionnaire has been adapted for South African conditions and needs. Furthermore, it also includes the questions on credit standards for approving applications for loans and credit lines out of the US “Senior Loan Officer Opinion Survey”.

Ensuring the reliability and accuracy of the financial sector survey

The questionnaire has been designed for maximum efficiency and minimum input time. Only multiple-answer type ticks are required. No figures are requested. For example, participants only have to tick if a particular activity (such as total income or number of people employed) is “up”, “the same” or “down” compared to the same period a year ago and with respect to their South African operations only.

Respondents are carefully selected and approached on the basis of their position in the financial world. The head of retail banking or the head of group life insurance is quizzed and not the chairperson of the board of directors of the group or holding company. Divisional heads tend to be best informed about their business units. The confidentiality of the responses adds to the honesty and candour of participants. Furthermore, respondent quality is monitored.

The same group of participants is surveyed from one quarter to the next. Changes in the results from one quarter to the next can therefore be attributed to an actual change in the performance yardstick in question and not because of the participation - or not - of particular banks, asset managers or life insurers.

South Africa has relatively few banks, asset managers and life insurers. For example, four banks dominate the retail and six the merchant and investment banking sector. Likewise, two companies dominate the life insurance industry. The number of potential participants in a financial sector survey is therefore relatively low in South Africa.

The degree of presentation of the panel of participants has an important impact on the reliability of a quantitative survey, i.e. when respondents have to indicate actual amounts for each activity and the rand value of the level and change are calculated. In contrast, the financial sector survey is a qualitative survey, i.e. the majority view of respondents on a particular activity is taken as an indication of the direction and strength of the trend in that activity. The degree of presentation of the panel of participants is less of a concern in the case of qualitative surveys. Furthermore, the participation - or not - of a particular respondent has less of an impact on the overall results in the case of qualitative surveys compared to quantitative ones, as the view of the majority is established and not the actual size.

The participating retail and investment banks accounted for 95% of total assets of registered banks in December 2007. The value of the total funds under management of the participating asset managers accounted for 63% of the total during the second quarter of 2007.

For reasons of focus, the following financial institutions are not covered, namely short-term insurers, public financial institutions (e.g. the Reserve Bank, Land Bank, Post Bank and official pension and provident funds), medical insurance savings schemes, the informal micro-lending and savings industry, retailers providing credit and individual insurance brokers/agents. The survey also only focuses on the supply of financial services and not on the demand for such services, which stems from government, businesses, households and the rest of the world.

The survey results reveal trends and not actual figures. The net balance statistic is used to interpret the survey results. (See next section for more details on the interpretation of the net balance statistic.) The net balance statistic is the percentage of respondents replying “up” less the percentage replying “down”. The percentage of respondents replying “the same” is ignored. Over the years, the net balance statistic has proved to be the most reliable indicator of the direction and size of change in the trend

of the respective activities surveyed. The net balance statistic is a qualitative yardstick of the direction and size of the year-on-year growth rate of a particular activity. A positive net balance implies positive year-on-year growth and vice versa. The higher the value of the net balance (positive / negative), the larger the rate of increase / decrease of the activity in question.

To aggregate the sector performance, individual responses are weighted according to their relative size. It makes sense that the response of a small participant has to count less compared to that of a large participant.

Results are published according to type of activity (e.g. retail banking, investment banking, life insurance and asset management) and not per institution (e.g. ABSA, Investec, Sanlam or Coronation).

How to interpret the net balance statistic

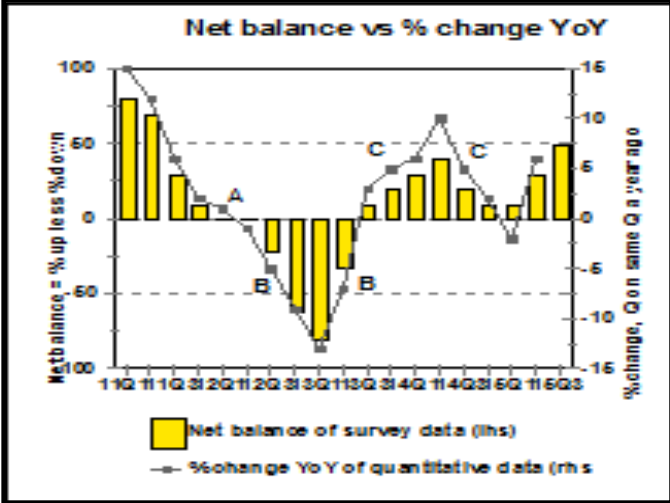
We base our interpretation of the survey results on the net balance statistic. Over the years, the net balance statistic has proved to be the most reliable indicator of the direction and size of change in the trend of the respective activities surveyed.

The net balance statistic is the percentage of respondents replying "up" less the percentage replying "down". The percentage of respondents replying "the same" is ignored. For example, if the percentage of respondents rating the volume of business higher / the same / lower compared to the same period a year ago is as follows:

Higher	Same	Lower	Net balance
70%	10%	20%	50%

Then we can conclude that the majority of participants experienced higher business volumes. A net majority (i.e. the percentage of respondents rating the volume of business higher less the percentage rating the volume lower) of 50% is registered in the above example.

The net balance statistic is an advanced qualitative yardstick / indicator of the direction (up, same or down) and size (small or large) of the year-on-year percentage change of the corresponding quantitative data (if available) of a particular activity. A net balance of zero tends to indicate no growth (marked "A" on the accompanying chart), between 0 and -100 a contraction (marked "B") and between 0 and 100 an expansion (marked "C") compared to the same quarter a year ago. A positive net balance, therefore, implies positive year-on-year growth and vice versa. The higher the value of the net balance (positive / negative), the larger the rate of increase / decrease of the activity in question tend to be.



Note that a net balance of -50%, for instance, is therefore not equivalent to a -50% decline (calculated year-on-year) in the quantitative data series. A net balance of -50% may correspond to -10% in the case of one set of quantitative data and -3% in another case. The net balance and corresponding percentage change in the quantitative data vary from one data set to the next and this relationship could only be established if many data points are available.

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