Contents

1  Executive summary
6  Asia-Pacific insurance outlook
18  Canadian life insurance outlook
28  Canadian property/casualty outlook
36  European insurance outlook
50  Latin America insurance outlook
62  Nordic insurance outlook
70  US life-annuity insurance outlook
80  US property/casualty insurance outlook
Executive summary
In 2013, the global insurance industry has never faced such a combination of turmoil, economic uncertainty and opportunity.

Although the US Congress agreed to a deal that effectively softens the “fiscal cliff” (and several European countries are evading bankruptcy), relief may be only temporary – with a decline in consumer savings still a looming concern. Interest rates are likely to stay at record low levels for the foreseeable future, and investment returns are likely to remain weak, compelling property/casualty carriers to improve underwriting margins. This will require difficult decisions on pricing and operating approaches.

Technology remains a bright spot as insurers continue to improve operational efficiencies and invest in analytical capabilities for business expansion, and improve the customer experience. Further automation of the value chain, new underwriting systems, rating engines and claims management solutions will entice more investment expenditures. Digital strategies and data analytics will become more important as insurers seek to boost returns from their existing customer base.

European insurers will focus more on managing risks to capital and investments, identifying new growth opportunities and adapting systems and operations to address these critical challenges. Nordic insurers face a varied economic climate in 2013 as they respond to local conditions. Both US and European life insurers are responding to demographic, macroeconomic and regulatory pressures by transforming strategies, products and services for a sustainable competitive advantage.

Significant top-line growth opportunities exist in the Asia-Pacific region, with even greater possibilities in the emerging markets of Latin America. We have seen a dramatic expansion in agency sales forces in these regions (very similar to the situation in the 1980s in the western hemisphere) over the past few years, and can expect a greater shift during 2013 toward business partnerships such as bancassurance.

In spite of these complex challenges, there are still many opportunities for insurers to seek competitive advantages and continue to thrive. The most successful will have strong corporate governance, the ability to quickly access and move capital, and low-cost, flexible and agile operating models.

We will see a huge split emerge between winners and losers in the global insurance industry in 2013. Yet, one thing is certain: the market size of property/casualty, life and savings businesses will be larger at the end of 2013 than it is today.

Our global insurance outlook explores these and many other issues confronting global insurance organizations in 2013. In this report, we offer our perspective on the insurance markets in Asia-Pacific, Europe, Nordic, US life and property/casualty sectors and the newly added Latin American market.

Shaun Crawford
Global Insurance Leader
The challenges and opportunities by region are:

**Asia-Pacific**

- In spite of an economic slowdown, significant top-line growth opportunities exist (particularly in emerging areas such as health insurance and pensions).
- Insurers need to be more selective in entering or exiting new markets, utilizing distribution channels and managing costs, while maintaining productivity.
- As regulators seek to bolster consumer confidence in the industry, insurers must consider the far-reaching implications of changing regulations on operations, structures and business models.
- The increasing severity and frequency of natural disasters are reshaping insurer views of risk, further demonstrating new dimensions of risk correlation and catastrophe modeling.
- Technology investment to support growth and improve risk management is a strategic necessity.
- Keeping pace with mobile technology will require new, innovative insurer distribution and service strategies.

**Canada life**

- As life insurers continue their successful de-risking and re-pricing initiatives, they are also maintaining or strengthening their balance sheet and capital positions.
- Managing to a new economic reality will require rethinking strategies for a sustainable competitive advantage.
- The industry is confronting significant regulatory and accounting changes that will impact existing processes, controls, resources and IT systems.
- To successfully meet profitability targets, companies must focus on expense efficiency, improved underwriting and sustainable cost reduction.
- Changes in distribution and consumer demographics are creating opportunities to capitalize on the risk transfer and savings needs of all ages from younger generations to retirees.
- Whether through product reinvention, tax strategies, sales force or asset liability management, life insurers will need to leverage innovation to achieve improved profitability.
Global insurance outlook

Canada property/casualty

- Organic growth remains a challenge, given the current economic situation and competitive landscape.
- Senior management must pay greater attention to expanding regulations governing insurance risk and capital management.
- Insurers can seize growth opportunities via acquisitions, and product solutions that target insurable risks and coverage expansion.
- To outperform competitors, insurers need to maximize customer profitability and persistency - a clear way is through investments in infrastructure and technology.
- Harnessing volumes of data may guide improvements in underwriting capability, customer service and the claims experience.
- Changing customer behavior will be driven by mobile technology and the growth of social media.

Europe

- Given the challenging economic climate, insurers must focus on managing risks to capital and investments, identifying new growth opportunities, and adapting systems and operations to respond to increasing regulation.
- Sharpened regulation will guide insurers to re-evaluate their business models and selling propositions as they seek to improve premium retention and growth.
- Consumers want simpler, more transparent products, a great customer experience and rewards for customer loyalty.
- Continued pressure on margins in a prolonged low-interest rate environment will compel insurers to limit their exposure to sovereign debt and protect their investment portfolios.
- It is critical to review and refine capital management strategies to be Solvency-II compliant, with the confidence to successfully implement these regulations by the proposed 2014 deadline.
- The volume and complexity of tax law will require keeping abreast of evolving developments, and adjusting business models accordingly.
**Latin America**

- Representing a bright spot on the global map, this region forecasts mid-single-digit real economic growth rates and sustainable profitability in 2013.
- An emerging middle class, slow-to-mature insurance market development and increasing needs for catastrophe risk cover are major contributors to long-term growth.
- Significant opportunities exist, particularly in Brazil and Chile, to integrate advanced risk and capital management with regulatory reforms.
- Substantial catastrophic loss exposures will require risk management tools and corporate governance that demand catastrophic risk management.
- As consumers embrace mobile technology, understanding their behavior will guide new and expanded forms of insurance product distribution.
- Flexibility, innovation and strategic alliances can enhance both market positions and technical strength.

**Nordic**

- Insurers face a varied economic climate as Denmark, Finland, Norway and Sweden respond to local conditions.
- The development and implementation of European regulation is affecting everything from capital and risk management to distribution and product design.
- Carriers must manage economic and regulatory risks to capital and investments, identify new opportunities to improve product and profit margins, and adapt systems and operations.
- Increased transparency around product pricing, costs and consumer benefits will be a key driver of growth.
- As insurers retool their investment portfolios in search of a better yield, they will need to “get back to basics”, trade off investment risk for insurance risk, and focus on risk selection and pricing.
• Demographic, macroeconomic and regulatory pressures are leading to a transformation of strategies, products and services to achieve a sustainable competitive advantage.

• With the average household life insurance expenditure down 50% in the last decade, insurers need to re-examine their consumer value proposition.

• The response to interest rate pressure has been to de-risk and redesign products, while improving capital and risk management.

US life-annuity

• Business and regulatory demands are driving investment in IT infrastructure, sophisticated modeling techniques and consumer analytics.

• Increased regulation requires reviewing policies, processes and controls to ensure that systems, data and resources are capable of implementing the new requirements.

US property/casualty

• A difficult, uncertain economic environment, and limited investment opportunities, are challenging growth and underwriting profitability.

• Weak investment returns and low interest rates are compelling carriers to make difficult decisions about pricing and operating approaches.

• Growth is achievable through international global expansion, acquisitions and product solutions that target new insurable risks and coverage.

• Opportunities exist to integrate and leverage “Big Data” across the entire value chain, from distribution and underwriting to customer service and claims.

• Early detection of potential adverse claims through analytical capabilities can sharpen competitive edge and yield cost savings in time of economic volatility.
Asia-Pacific
Where to go from here?
Market summary

As in past years, it is somewhat difficult to provide a meaningful insurance industry outlook for a region that is so geographically and culturally diverse, and at various stages of economic development.

While some insurers operate across multiple geographies, the majority of companies operate locally. Nevertheless, all insurers in the region are asking the following questions:

- What type of business do we want to pursue – market leading, niche, product manufacturer, distributor, multinational?
- What markets do we want to be in, and should we expand domestically, regionally or change product lines?
- How do we get to where we want to be while achieving profitable growth?

As insurers ponder these questions, they are cognizant of an economic slowdown and changing regulatory conditions. While there has been a slowdown in economic growth and lower interest rates, top-line opportunities are significant in both developing and mature markets. For insurers operating in developing markets, growing wealth from the burgeoning middle class represents a major source of premium and profit potential, via the sale of wealth management and personal lines insurance. Insurers operating in more mature markets can grow by enhancing product and service offerings to meet the more complex financial planning needs of consumers. Insurers pursuing these opportunities must also deliver an acceptable return on capital.

Regulators in many markets are evaluating efforts in Europe and the US to strengthen insurer solvency, and taking steps in this direction. These actions will likely lead to the development of country-specific solutions, such as the life and general insurance capital standards in Australia (LAGIC), rather than a common or unified regional regulatory scheme. Ernst & Young’s expectation is that the majority of the region will experience common regulatory approaches and language, but the rules will be appropriate to their own market’s situation. Beyond prudential regulation, regulators are focusing on improving consumer protection and increasing product transparency. As regulations develop, insurers need to adapt their products and business models accordingly.
Balancing these prospects and risks will be a prime consideration for insurers in 2013. Companies operating in a single country must sharpen their competitive advantage. Companies operating in multiple countries must assess which markets are providing an acceptable return on the capital placed at risk, and which are not. Complicating these issues is the diversity of mature, developing and emerging insurance markets across the region. Nevertheless, by selecting the right markets, insurers can finally deliver on the promise that Asia-Pacific represents. Making poor choices, on the other hand, can be an expensive “false dawn.”

Consistent with previous outlooks, the insurance market for each location is designated as mature, developing or emerging:

### Asia-Pacific region

<table>
<thead>
<tr>
<th>Country</th>
<th>Forecast 2013 GDP change</th>
<th>Forecast 2013 CPI change</th>
<th>2011 population (millions)</th>
<th>2011 life insurance premium (million USD)</th>
<th>2011 non-life insurance premium (million USD)</th>
<th>2011 life insurance penetration (premium % of GDP)</th>
<th>2011 non-life insurance penetration (premium % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>3.00%</td>
<td>2.50%</td>
<td>21.8</td>
<td>$45,187</td>
<td>$43,899</td>
<td>3.00%</td>
<td>3.00%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4.50%</td>
<td>3.30%</td>
<td>7.1</td>
<td>24,556</td>
<td>3,293</td>
<td>10.10%</td>
<td>1.40%</td>
</tr>
<tr>
<td>Japan</td>
<td>1.70%</td>
<td>0.70%</td>
<td>126.8</td>
<td>524,668</td>
<td>130,741</td>
<td>8.80%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Korea</td>
<td>4.00%</td>
<td>3.00%</td>
<td>49.0</td>
<td>79,161</td>
<td>51,223</td>
<td>7.00%</td>
<td>4.60%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>2.60%</td>
<td>2.60%</td>
<td>4.4</td>
<td>1,548</td>
<td>8,503</td>
<td>0.90%</td>
<td>5.20%</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.50%</td>
<td>2.50%</td>
<td>4.9</td>
<td>11,275</td>
<td>8,188</td>
<td>4.30%</td>
<td>1.50%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>4.60%</td>
<td>1.60%</td>
<td>23.3</td>
<td>64,133</td>
<td>14,283</td>
<td>13.90%</td>
<td>3.10%</td>
</tr>
</tbody>
</table>
## Developing

<table>
<thead>
<tr>
<th>Country</th>
<th>Forecast 2013 GDP change</th>
<th>Forecast 2013 CPI change</th>
<th>2011 population (millions)</th>
<th>2011 life insurance premium (million USD)</th>
<th>2011 non-life insurance premium (million USD)</th>
<th>2011 life insurance penetration (premium % of GDP)</th>
<th>2011 non-life insurance penetration (premium % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>8.70%</td>
<td>4.00%</td>
<td>1,363.7</td>
<td>$134,539</td>
<td>$87,319</td>
<td>1.80%</td>
<td>1.20%</td>
</tr>
<tr>
<td>India</td>
<td>7.50%</td>
<td>6.50%</td>
<td>1,232.8</td>
<td>60,442</td>
<td>12,187</td>
<td>3.40%</td>
<td>0.70%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5.00%</td>
<td>2.80%</td>
<td>28.4</td>
<td>9,307</td>
<td>4,965</td>
<td>3.30%</td>
<td>1.80%</td>
</tr>
<tr>
<td>Thailand</td>
<td>5.50%</td>
<td>3.30%</td>
<td>68.6</td>
<td>9,218</td>
<td>6,028</td>
<td>2.70%</td>
<td>1.70%</td>
</tr>
</tbody>
</table>

## Emerging

<table>
<thead>
<tr>
<th>Country</th>
<th>Forecast 2013 GDP change</th>
<th>Forecast 2013 CPI change</th>
<th>2011 population (millions)</th>
<th>2011 life insurance premium (million USD)</th>
<th>2011 non-life insurance premium (million USD)</th>
<th>2011 life insurance penetration (premium % of GDP)</th>
<th>2011 non-life insurance penetration (premium % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>6.70%</td>
<td>5.00%</td>
<td>235.3</td>
<td>$9,437</td>
<td>$4,655</td>
<td>1.10%</td>
<td>0.60%</td>
</tr>
<tr>
<td>Philippines</td>
<td>5.00%</td>
<td>4.10%</td>
<td>95.4</td>
<td>1,890</td>
<td>991</td>
<td>0.80%</td>
<td>0.40%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>6.20%</td>
<td>11.50%</td>
<td>88.8</td>
<td>818</td>
<td>1,027</td>
<td>0.70%</td>
<td>0.90%</td>
</tr>
</tbody>
</table>

Sources: Bank of Japan, Reserve Bank of Australia, New Zealand Treasury, Asian Development Bank, Swiss Re
In 2013, domestic and international insurers in Asia-Pacific will benefit from the region’s organic premium growth potential, brought about by high levels of economic growth and rising insurance penetration rates.

In 2013, a number of factors will influence insurers’ strategies in Asia-Pacific, including:

- Clarity on the best growth opportunities (including emerging areas like health and pensions)
- Implications of a rapidly changing regulatory environment
- Manage the evolving regional catastrophe risk
- The need to invest in technology to enable growth and improve operations and risk management
- The need to innovate new services for the mobile technology revolution
Clarity on the best growth opportunities

In 2013, domestic and international insurers in Asia-Pacific will benefit from the region’s organic premium growth potential, brought about by high levels of economic growth and rising insurance penetration rates. Our outlook last year indicated that growth-seeking insurers would look to Asia-Pacific, and this continues to be the case. The region leads the world in expected GNP growth rates, despite a slowdown in overall global economic growth. Standouts include China, Hong Kong, India, Indonesia, Vietnam, Malaysia and Thailand. Each country has experienced rapid development of its financial markets and services sectors.

In the current economic environment, insurers will need to be more selective about which markets to enter or exit, addressing both geographies and product lines; which distribution models to utilize; and how best to manage costs while maintaining productivity. Mergers, acquisitions and divestitures are increasingly on the agenda for local, regional and non-Asian insurers. Desirable targets include companies with access to strong bancassurance or other distribution channels, entities with an established presence in the market, companies with a complementary product set, and organizations that have already invested in new technologies to reach customers. An increase in transaction activity is expected, with non-insurers focused on distribution access. Insurers need to ensure their goals and strategies are aligned with the target acquisitions, and that they have invested in the operational support systems to make the ventures succeed.

The increasing emergence of health insurance and pensions across the region presents another growth opportunity. It is anticipated that many insurers will critically assess how to access the high potential represented by these markets in 2013, although implementation of these plans via transactions and/or distribution agreements may take longer to materialize.
The pension opportunity

The global financial crisis expedited pension reform in the region. Over time, the reforms will make pension and retirement assets the largest source of wealth in many countries. Securing these increased retirement savings requires behavioral and regulatory changes of existing systems.

Pension reform is underway for three reasons:

• The long-term financial implications of unfunded pension obligations on some governments’ budgets and liability, such as Taiwan and parts of Australia

• Less than satisfactory investment returns attracting a “value for money” debate by governments, putting focus on fees, efficiency and the quality of financial advice – Australia and Hong Kong are examples

• The need in countries like Singapore and China to enhance their social welfare and pension systems to reach their respective next levels of system maturity

**Percentage of population age 60+: 2009 and 2050**

- China
- China, Hong Kong SAR
- Japan
- Republic of Korea
- India
- Indonesia
- Malaysia
- Philippines
- Singapore
- Thailand
- Vietnam
- Australia
- New Zealand

There are several opportunities for insurers in the region to assist governments and private sector companies in the new pension reform era, and insurers can apply their overseas experience.

Leading insurers can fulfill customer retirement needs by leveraging their position as a gateway to financial products. Innovative, flexible US-style, long-term care products show great initial take-up, and may assist in growing the social insurance market in China and elsewhere.

Insurers also can leverage their risk management capabilities and capital to offer outcome guarantees, particularly during the retirement phase. Life insurers have significant scale and experience in investment management that they can apply to the pension industry. Insurers also can help drive efficiencies in administration processes, and enable straight-through processing and online interaction and transaction solutions for employers, intermediaries and retail customers. This would provide insurers with greater scale, and pension providers with reduced costs and increased customer satisfaction. Benefits could be shared between different stakeholders, resulting in lower fees for pension members.

Finally, insurers can leverage their distribution experience to stimulate social welfare and pension initiatives. The distribution experience, infrastructure and capabilities of life insurers could help expand the availability of pensions in China for urban and rural workers, and assist the expected pension pilot in Shanghai and the new voluntary retirement savings solution in Malaysia. Life insurers may need to evolve their distribution forces from a sales force into a light version of personal financial advisers. In this regard, countries like Australia can act as an example.

**The health opportunity**

Health care reform is underway across the region, creating significant opportunities for insurers to work with governments in providing expertise, systems and products in support of the development of an efficient health care regime. In July 2012, for instance, health care ministers from ASEAN (Association of Southeast Asian Nations), Japan, China and South Korea, met and committed to establishing a network for universal health coverage, while building national and regional capacity for an efficient health system supporting universal coverage.

Other opportunities are available in developed markets like Australia. In this regard, health insurers must assess their competitive advantages and in which parts of the value chain they want to operate.
Implications of a rapidly changing regulatory environment

Insurers in Asia-Pacific are confronted by a patchwork of insurance regulations. Although regulators are moving toward functional equivalence with developing European Solvency II and US risk-based capital (RBC) standards, the region lacks the political unity of the US and Europe—the regulatory regimes it is emulating.

Asia-Pacific insurance regulations are not likely to be carbon copies of the European and US models, as regulators appreciate that each Asia-Pacific market has its own unique features. Examples include high growth rates, the existence of tariffs for many statutory classes, the presence of Sharia-compliant insurers in certain countries, the existence of investment and reinsurance limitations in some markets, and the shortage of long-dated government debt. Some regulatory requirements, such as data granularity and qualified staffing, are not likely to be implemented soon, although the adoption of capital models, enterprise risk management, IFRS accounting standards and increased consumer protections are anticipated or already under development across the region, with some markets like Australia considered early adopters.

On a country-by-country basis, India is moving from a Solvency I approach to Solvency II, and China is similarly shifting to a more risk-based approach. China’s regulatory body, CIRC, has raised insurer governance standards, requiring insurers to have designated risk functions headed by a Chief Risk Officer, as well as a risk management committee that reports to the board of directors. Japan has formally sought regulatory equivalence with Solvency II. In Indonesia, Thailand and Malaysia, three markets that historically have been comprised of numerous smaller insurers, the higher minimum capital requirements are driving consolidation.

Insurance accounting standardization has advanced with IFRS convergence pursued across the region. Since IFRS for insurance is at an interim stage of development, true harmonization will not be achieved until the completion of the second phase of the insurance accounting project. Some jurisdictions, such as Australia and Hong Kong, have adopted IFRS standards completely, while others have achieved partial compliance or provided detailed roadmaps towards full compliance. Japan has requested more time to comply with IFRS convergence, given the financial disruption caused by the 2011 Tohoku earthquake, and China has voluntarily aligned with IFRS.

Regulators seeking to bolster consumer confidence in the insurance industry also are implementing measures to increase product transparency and service standards, and have heightened their reviews of policy wordings and premium rates. Examples include the move by the Monetary Authority of Singapore to consider higher qualifications for insurance agents, South Korea’s FSS inspections of insurance sales, and the IRDA’s guidelines in India to prevent mis-selling of policies. Higher professional and educational standards for agents and financial advisors have been adopted in countries as divergent as Australia and Vietnam.
Against this backdrop of regulatory change and diversity across the region, insurers in 2013 must consider far-reaching changes to operations and structures. Many companies face difficult decisions, including rebalancing the product mix based on capital allocations, which businesses and lines to exit, and which reinsurance strategies are optimal, given recent natural catastrophes.

**Manage the evolving regional catastrophe risk**

Natural disasters in Asia-Pacific, such as the Tohoku earthquake and tsunami, earthquakes in New Zealand and the massive floods in Thailand and Australia, are reshaping insurer views of risk and reinsurance. While reinsurance has been utilized extensively in the mature insurance markets, many insurers in developing markets historically refrained from buying catastrophe reinsurance, preferring instead to maximize retained premium. This posture is changing, however.

More severe and frequent catastrophes now appear more likely to occur than previously thought, compelling insurers to cede more risk to reinsurers. While reinsurance as a form of capital relief can yield positive results for managing capital requirements, it needs to be balanced against the rising cost of reinsurance premiums. With additional reinsurance capacity now available, governments are re-evaluating their roles vis-à-vis catastrophes, and how to transfer such risks to commercial markets. A challenge for many markets in Asia-Pacific is the affordability of insurance; thus simply passing on the increased cost of reinsurance is often not an option.

The recent catastrophes further demonstrate new dimensions of risk correlation. Losses from the Thailand floods, for instance, revealed the magnitude of business interruption problems elsewhere. The floods disrupted automobile production in Japan, and caused contingent business interruption losses for insureds in Europe and North America. Such interconnections add another dimension to catastrophe modeling.
The need to invest in technology to enable growth and improve operations and risk management

Possessing the technology to enable the aforementioned growth and effectively support operations and risk management is a business imperative for many insurers in 2013. The introduction of more complex products and data analytics, in combination with risk-based regulations, are pushing legacy systems and processes to the limit. Consequently, insurers must invest in technology upgrades to support growth and improve operations and risk management.

In some markets, more complex products are being introduced to meet the needs of a wealthier customer base – the case in China with variable annuities (VA). The hedging programs used to effectively manage the risks created by such complex products require significant technology commitments. Even for non-life insurers, analytics offers the potential to reduce pricing and improve underwriting, although it requires a very different technology mindset.

As previously mentioned, the emerging regulatory environment will act as a catalyst for companies to replace their disparate legacy IT systems. Singapore’s Monetary Authority, for example, recently proposed new risk-management requirements addressing the identification and management of the interdependencies among key risks. India’s IRDA plans to impose a minimum retention limit on the risk that must be retained by insurance companies and not ceded to reinsurers. Legacy systems may not produce the comprehensive data needed to effectively evaluate company risks and products. Many systems were not designed for multiple currency/multiple product strategies or the wide range of riders issued. For insurers developing cross-border operations, data security and the integration of diverse back-office systems are further challenges.

Building a business case for technology investments at a time of intense competition is difficult, of course. Insurers will need to prioritize these expenditures and justify the benefits versus the cost, although for many carriers, technology investment is a strategic necessity.
Innovate new services for the mobile technology revolution

As consumers increase the use of mobile technology, insurers must keep pace with products and services catering to the mobile lifestyle. This will require new insurer distribution and service strategies in 2013.

With 2.9 billion mobile subscriptions at the end of 2010, Asia-Pacific accounts for half the world’s mobile population, and China alone boasts the planet’s largest mobile market. Mobile consumers have demonstrated a willingness to experiment with new technologies and the content these technologies deliver.

Alternative distribution channels like web portals and mobile are being implemented in the region to supplement or replace traditional agencies, although bancassurance continues to grow. IDI Financial Insight’s 2012 survey of Asian insurance consumers (excluding Japan) found that 60% use more than one interaction point to purchase non-life policies, and the mobile channel is increasingly popular. Ernst & Young’s own global consumer survey also found that more consumers are researching products and carriers online prior to the purchasing decision.

Mobile interactions are leading some insurers to develop new services. India’s LIC launched a mobile phone app to provide product information to customers and agents, and AIA Singapore plans to develop Smartphone and iPad apps targeting younger customers.

While advanced economies like Singapore and Japan have introduced sophisticated online marketing campaigns, other countries, such as India, Indonesia and the Philippines, await telecom infrastructure improvements and increased consumer knowledge before following suit. In some developing markets, mobile technology is yet to gain a significant foothold. In 2013, insurers need to identify solutions to these challenges to retain market share and gain competitive advantage.

Conclusion

We expect the challenges and opportunities that insurers confronted at the onset of 2012 to continue into 2013. As in the past, the Asia-Pacific region offers great potential for insurers. Significant top-line growth opportunities are in the offing from the growing population, a rapidly developing customer base, and regulations that support the development of a financially sound industry.

Nevertheless, 2013 will be a year of decisions for insurers in Asia-Pacific – insofar as how best to access the region’s growth, how to position operations and infrastructure, and how to leverage the enormous demographic and technological changes in both the region and the world at large. These are not easy decisions, and not everyone will succeed in making the right choices.
Canadian life

Innovating products, operations and strategy for a new generation of buyers
Market summary

While it serves the life insurance industry in Canada to review the risks and trends of its counterparts in the United States, a market with which it shares similar characteristics, each does not move in lockstep with the other. Consequently, this report presents an overview of Canada’s life insurance industry as a separate and unique market, although it addresses specific US trends and issues where relevant.

On the whole, 2012 was mixed for the Canadian life insurance industry. On the positive side, many companies continued the successful trends of de-risking and repricing initiatives. They maintained or strengthened their balance sheet and capital positions, driven in part by a better-than-expected performance by the equity markets. In addition, insurance companies enjoyed relatively low inflation and unemployment figures. Challenges included continuing slow growth, low interest rates, the resurfacing of significant sovereign debt issues, increases in household debt and a softening in the Canadian economy.

We expect most of these issues to persist through 2013 for larger insurers and become more apparent for medium and smaller insurers. For example, the low interest rate environment will likely continue, the Canadian economy (although not expected to decline) will not grow as quickly as some had hoped and the chase for yield will quicken. These challenges require the life insurance industry in Canada to rethink both business strategy and operations in 2013 to achieve profitability targets.

In addition to these macroeconomic factors, Canada’s life insurers also confront regulatory challenges from initiatives addressing actuarial reserving, capital, solvency, governance and risk. Companies must optimize operating and administrative costs, understand and act upon evolutionary changes in consumer needs and distribution channels, and find ways to differentiate themselves in the marketplace.

Successful players in 2013 will need to creatively adjust their products, business strategies and services to position their companies for growth and profitability in a competitive market characterized by lower margins and changing demographics.

To productively respond to these market forces in 2013, Canada’s life insurers will need to consider the following:

- Rethink strategy for sustainable advantage
- Manage to a new economic reality: slow growth and long-term low interest rates
- Address changes in distribution and consumer demographics
- Position the business for regulatory and accounting change
- Turn operational excellence and technology into competitive advantage
Rethink strategy for sustainable advantage

Over the last several years, Canadian life insurers have taken steps to de-risk and reprice risk. Insurers have also discontinued some guarantees and exited blocks of business. Despite these moves, products for the most part are the same, though some are under pressure.

For example, variable products have become less attractive because of continuing volatility and price, and fixed products are not competitive enough due to their low credit rates. To be successful, Canadian insurers will have to look at introducing new products and features that are both attractive to consumers and profitable for business in the low interest rate environment.

The Canadian life insurance market is largely unchanged in terms of the players, with a few large companies and several medium-sized and smaller ones. Canadian life insurers enjoy a relatively good position: capital and economics have been solid throughout the financial crisis and subsequent recession, and for the most part, insurers have recognized the impact of low interest rates and equity markets in their results.

Although larger insurers continue to enjoy robust assets and market share, they confront difficulties growing organically and may seek to move into lines outside their core business. On the other hand, they may want to grow non-organically by acquiring businesses outside Canada.

Smaller insurers seeking profitable growth may resist offering the same products that larger insurers provide and focus instead on niche market opportunities, such as offering unique products or serving specific demographics. These plays may require a cultural change. Smaller insurers also may want to develop new products to diversify their risks, regardless of the macroeconomic environment, and fill the void left by discontinued products, such as various guarantees, where there is still a market need.
Given the pronounced need for scale in the current economic environment, the best strategy for some small insurers may be joining forces. Some insurers may engage in joint ventures around the packaging and distribution of complete insurance solutions; others may seek to be acquired by larger foreign insurers with the financial means and ability to become a large Canadian company. This may be an attractive option for well-established foreign insurers, due to the relative stability of the Canadian insurance market and the fact that many insurers’ books largely reflect fair value, in addition to the aforementioned positive market factors.

All in all, many Canadian insurers are in better shape than their US counterparts. Given the marked-to-market accounting model, the impact of the low interest rate environment was immediately recognized in their results and swiftly mitigated.

With regard to distribution, consolidation among distributors remains a challenge. Some larger carriers are examining their distribution channels, given the aging population of their brokers and management general advisors (MGAs), combined with changes in consumer demographics and preferences. Others are reconsidering the merits of captive or career sales forces, even as others actively rebuild these forces or develop channel-specific products that more closely tie independent distributors to them. With fewer independent advisors and brokers, competition for shelf space is heating up.

To augment or replace traditional channels, both insurers and distributors should consider ways to reach potential buyers that leverage these consumers’ increasing technological sophistication, exploiting technology and data to improve business models and product offerings.

By enhancing the value proposition, and restructuring operations and distribution models to communicate and transact with customers on their terms, Canada’s life insurers should be able to improve profit margins.
Manage to a new economic reality: slow growth and long-term low interest rates

After several years of dashed hopes that the slow growth and low interest rate environments would improve, it now appears that these challenges will persist, perhaps for several years. The most recent Bank of Canada forecast indicates interest rates will remain unchanged in 2013.

In the US, a market that supplies a significant portion of fixed-income investment in Canadian life insurers’ investment portfolios, the Federal Reserve announced at the end of 2012 its third program of quantitative easing, dimming the likelihood of higher interest rates south of the border, as well.

In Europe, interest rate pressures are accentuated by the European Central Bank’s stimulus package for afflicted national economies, and the sovereign debt issue has eroded investment propositions for several European countries.

Against this backdrop, the industry’s business strategy needs to address the likelihood of long-term low interest rates. Interest rates will eventually rise at some point, but life insurers comprehend that time lost in subpar yield conditions cannot be recovered. Consequently, they can no longer manage on a short-term crisis basis. A complication, of course, is insurers’ limited ability to reduce interest rate risks for savings- and investment-oriented products. Product mix and features will have to change to provide higher profitability.

The main response to these conditions has been a review of existing product portfolios to reprice or eliminate high-risk, capital-intensive, low-margin products, while seeking profitable ways to maintain or gain scale. Insurers have reduced the minimum guaranteed credit rates and de-risk certain products, while continuing to seek higher-margin products and higher-yield investments. To obtain higher yield, insurers may need to increase risk taking in their asset portfolios, assuming they are adequately compensated in yield for absorbing the additional risk.

There has also been a renewed focus on asset management and wealth management and less interest in costly and risky guarantees. To a certain extent, these approaches have reached the market limit – insurers now must turn their attention toward building innovative and attractive products.
Whether through product reinvention, tax strategies, sales force or asset-liability management, life insurers will need to leverage innovation to achieve improved profitability.

Equity and credit market volatility are other compounding issues. Prior to the financial crisis, these risks were thought to be well understood and adequately priced — but that has not been the case in hindsight. Income from products involving asset-based management fees has been volatile, decreasing earnings. Hedging programs are less effective and more expensive. As a result, the life insurance industry must decrease risk exposure and enhance features that appeal to consumers.

Since insurance companies are paid to bear risks that customers are unable to bear, decreasing the amount of absorbed risk seems at odds with enhanced product value, especially when customers are less capable of taking on risk in the current economy. Life insurers have acted to address this situation, increasing fees for variable products, reflecting the cost of hedging in the volatile economy; restricting investments that limit the amount of risk assumed by customers; and implementing automatic rebalancing to protect customers from significant asset value movement, while also stabilizing the insurer’s fee income.

Product-oriented techniques that reduce volatility for both customers and insurers will be better received. Insurers can reduce risk by marketing product characteristics that customers appreciate and removing those features they dislike. This can foster the provision of simpler, flexible products with clearer, comprehensible value propositions. Whole life insurance and term life insurance, for instance, are popular because of their easy-to-understand, straightforward value propositions.

The life insurance business is built on demographics. Insurers must capitalize on the risk transfer and savings needs of all ages, from the young to pre-retirees and retirees.
Address changes in distribution and consumer demographics

A significant portion of the Canadian market has long been centered on the accumulation of assets under management and complex retirement savings and insurance products. These products made sense for a population that today is retired or near retirement. Such customers largely preferred an interaction with a live salesperson selling the product, rather than proactively buying it themselves.

Today’s consumers in generations X and Y have different product needs and buying preferences. They prefer to conduct research online, are much more receptive to advice from their social networks than from live sales pitches and are more likely to buy online. Insurers need to reflect these differences in their value proposition to these younger consumers, especially in relation to their wide embrace of the internet, social networks, and virtual interactions and communications. In this regard, product distribution and consumer demographics are key factors.

The life insurance business is built on demographics. Insurers must capitalize on the risk transfer and savings needs of all ages, from the young to pre-retirees and retirees. In the current market conditions, products such as term life insurance and whole life insurance will generate interest among younger consumers because they are simpler, easier to understand and make sense.

It is essential that insurers maintain an effective internet and social media presence and create mobile applications offering faster and easier connections with consumers. This, in turn, requires effective mitigation of the related risks, such as data security and privacy and regulatory mandates on the use of the internet and social media.

Position the business for regulatory and accounting change

Canada’s life insurance industry also is confronted by significant regulatory challenges, as are markets elsewhere across the world. In 2012, the Office of the Superintendent of Financial Institutions Canada (OSFI) issued proposed regulations addressing governance and risk, as well as its road map of future regulatory framework. Provincial regulators also may become more active in areas such as insurance distribution and MGA licensing and regulation. Securities regulators, meanwhile, continue to scrutinize financial reporting and public disclosure and may require more transparency.
In addition, emerging international accounting standards may adversely affect business models, operations and capital levels, while solvency and capital direction are up-and-coming regulatory challenges.

In August 2012, OSFI issued its draft Corporate Governance Guidelines, and issued its final in January 2013. This revision of its 2003 guidelines focuses on several areas, such as risk and risk awareness in the Canadian life insurance industry, in addition to the composition and roles of both boards and audit committees. Other guidelines address the roles of governance, risk management and human resource committees; the independence of various management and board roles; and the role and responsibility of the Chief Risk Officer. Larger insurers have already embedded some of these concepts as part of their governance; for smaller insurers, implementing these changes may be onerous.

Solvency, capital calculation, adequacy and risk are other issues in the regulatory crosshairs. In September 2012, OSFI issued its Life Insurance Regulatory Framework, which presents the changes it expects over the next four years. Some are based on models similar to those seen under Solvency II in the European Union and the Risk Management and Own Risk and Solvency Assessment Model Act (ORSA). Solvency II has now been delayed to 2016, and in the US, the National Association of Insurance Commissioners is closer to introducing its solvency modernization initiative, passing the aforementioned ORSA model law and undertaking work on its capital formula and factors. Risk governance and risk management are at the heart of these initiatives.

Implementing an ORSA-like approach requires a well-developed and effective enterprise risk management framework, which insists upon significant senior management, information technology (IT) and other operational time and effort. Life insurers must seek to understand these details as they are firmed up, and they should consider how to reflect the changes in their plans and strategies. Life insurers must determine, for instance, who has the responsibility within the organization for establishing risk management policies and risk appetite, as well as the extent of management and the board's technical understanding of the nature of enterprise risk.

Securities regulators and those responsible for consumer protection both continue to scrutinize the transparency and fairness of diverse financial products and services, including public disclosures of risks and results. Life insurers must review their disclosure practices with regard to product and financial instrument prospectuses, including their presentation and disclosures with respect to financial statements and Management Discussion and Analysis documents.
On the accounting front, both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board are continuing their work on the insurance contracts projects under the International Financial Reporting Standards (IFRS) and US generally accepted accounting principles. Current status of the projects indicates that approaches to insurance accounting will change under both standards.

Exposure drafts from both bodies (re-exposure in the case of the IASB) are expected within the first half of 2013, with final standards likely in place in 2014. The effective date will not be before 1 January 2015 and is anticipated to be no earlier than 1 January 2016. Some projections put the date as late as 1 January 2018.

For Canadian life insurers, the proposed valuation model shares many similarities with the Canadian Asset Liability Method, currently used for the valuation of actuarial liabilities in Canada under IFRS. IASB made significant changes to the proposal in its 2010 exposure draft, in part as a result of feedback from the Canadian life insurance industry. However, the new model must be carefully read and understood, given the subtle differences that may have enterprise-wide consequences. Life insurers must make sure that their systems, people and data are prepared and capable of implementing the new requirements, and they must have reviewed the potential impact on profitability and products.

The re-exposure draft is expected to have a comment period that will coincide with the third quarter of 2013 and draw to a close by fall 2013, meaning this will be the last opportunity to influence the insurance contract project process. Ahead of implementation, insurers should educate their staff on the subject and participate in the current debate to influence developments. They could also evaluate possible alternatives to the standards through a pilot test.

These anticipated regulatory and accounting changes will have an impact on insurers’ existing processes, controls, resources and IT. It is important that insurers understand and take into account these limitations when embarking on internal projects that include IT systems and other transformations.
**Turn operational excellence and technology into competitive advantage**

To successfully meet profitability targets in 2013 and beyond, Canada's life insurers must focus on expense efficiency, improved underwriting and sustainable cost reductions. Operations and technology are key areas that can be turned into a competitive advantage from an efficiency and sustainable cost reduction standpoint. Outsourcing and a focus on core businesses, for instance, are both cost-effective strategies, as are process consolidations and more simplified operating structures.

US insurers have been forced by the economic crisis to take significant steps toward operational excellence. To achieve similar efficiency, compete more effectively and increase margins, Canadian life insurers need fundamental process changes, such as investments in technology, predictive modeling and consumer analytics.

Many Canadian life insurers continue to use legacy systems that require significant resources to operate. In addition, these systems are not flexible enough to provide the kind of business and regulatory information required for strategic, operational and compliance purposes. The industry must continue to invest in technology to reduce costs and increase profits, creating the necessary data to analyze, and thereby improve, decision-making.

Such data can be used for predictive modeling and consumer analytics, as well as speeding the underwriting process, to result in faster policy issuance and higher sales. Predictive modeling further decreases sales and marketing expenses, leveraging customer preferences to target those individuals most likely to purchase products, while facilitating targeted risk selection to guide better underwriting performance.
Canadian property/casualty

A new generation of customers and technology presents potential for growth
Market summary

The challenging economic and market conditions of recent years linger as the global economy slowly recovers. Consequently, Canadian property and casualty (P&C) insurers will need to focus their efforts in 2013 on positioning their companies for growth.

The continuing weak investment returns brought about by low interest rates require insurers to enhance their underwriting capabilities and manage costs to improve the bottom line. Organic growth also remains a challenge, given the current economic situation and the competitive landscape. In addition, senior management must provide keener attention to expanding regulations governing insurer risk and capital management.

Despite these challenges, P&C insurers can seize growth opportunities via acquisitions, as well as by developing product solutions that target new insurable risks and coverage expansion. In this era of changing demographics, new technologies such as vehicle telematics may provide the marketing cachet to reach urban condominium dwellers with customized insurance products. In this regard, insurers must heed consumer preferences and the ways in which they want to be contacted. Decisions relating to distribution channels and customer interactions will play a larger role in both growing and sustaining market share.

To outperform competitors, insurers need to maximize customer profitability and persistency, and a clear way to do this is through investments in infrastructure and technology. Many P&C companies are in the early stages of investing in internal data and systems capabilities, yet their investments have already provided information advantages and improved analytical and decision-making capabilities.

Canadian P&C insurers must approach these challenges and opportunities holistically, understanding their respective impact on underwriting, operations and investments. Consequently, growth and profitability strategies need to be developed on an enterprise-wide basis, always balanced against the risks these strategies may create.

To productively respond to these market forces through 2013, Canada’s P&C insurers will need to consider the following priorities over the coming months:

- Identifying growth and cost-containment opportunities
- Customer preferences and the distribution network
- Harnessing data for intelligent underwriting
- The changing regulatory and reporting landscape
Identifying growth and cost-containment opportunities

The need to grow challenges Canadian P&C insurers, yet there are obstacles in the way, chiefly the uncertain economic environment and continuing difficulties deriving from the global recession and low interest rates.

As economic conditions begin to improve, insurers can no longer be content with merely maintaining profitability through modest underwriting results. They must seek and embrace new ways to grow premiums and exposures. In the absence of a clear hard market, organic growth will remain difficult; companies therefore need to explore and exploit external opportunities.

Acquisitions are a way for insurers not only to increase revenue but to grow and diversify exposures — via new products, new distribution networks and an expanded geographic presence. In recent years, there have been several large acquisitions by Canadian P&C insurers. Yet, insurers should not consider such transactions solely in the context of large multinational takeovers — acquisitions span a wide spectrum, including a merger with another company or acquiring specific individuals or teams of employees to expand and improve product and/or distribution capabilities.

Through such growth and diversification strategies, insurers become exposed to new and unique risks, as well as integration, cultural and regulatory challenges. Business integration issues can be significant, as companies have to adapt to different company cultures, systems and even accounting and reporting policies. Following what has been quite a bit of consolidation in the Canadian P&C industry, systems integration is a key problem, making it difficult to obtain historical information for current and future use. Insurers must exercise care in planning their acquisition and growth strategies to maximize the competitive advantages going forward.

Insurers may also find a competitive advantage by specializing in market niches. Premium growth opportunities may come from insuring new or emerging exposures. Cyber liability insurance, for example, has been an emerging product following the recent increase in corporate and public data breaches.

The development of new technologies by businesses in a variety of industries also may generate new opportunities. There is rising demand for protection from risks deriving from these technologies, creating an opportunity to gain significant market share and profits. At the same time, insurers must be aware of the loss uncertainties and other unknowns.
associated with these emerging risks, which challenge modeling, product pricing, coverage design and underwriting. Since emerging risks tend to focus on newer causes of loss, this suggests that underwriting assumptions will be based on limited historical data.

Clearly, Canadian P&C insurers will need to rely on extensive research, innovation and expertise to profit from these new markets, whether geographical or technological. In particular, expansion requires that carriers obtain new execution and risk monitoring capabilities, either internally or through arrangements with qualified business partners.

Enhanced operational efficiencies are another industry necessity in 2013. In this regard, new market entrants have a competitive advantage, as they are not burdened by legacy infrastructures. Customer service remains a differentiating characteristic among insurers, and adequate resources are necessary to meet customer expectations, as well as compete effectively.

Multi-line insurers also may seize premium growth opportunities by cross-selling their products to customers. According to Ernst & Young's Global Consumer Insurance Survey 2012, roughly half of the consumer population prefers to buy multiple products from the same provider, citing convenience and value as the key factors.

Despite these preferences, most insurance companies fail to take advantage of opportunities to market additional policies to clients (apart from increasingly common combination homeowners and automobile policies). Cross-selling insurance products for travel, valuable articles, mortgages and boats can improve profitability and increase customer retention. By using marketing data to target those consumers most likely to buy multiple policies, insurers can efficiently expand their businesses and increase retention over the long term.

Many companies have also undertaken strategic reviews of their existing product portfolios to refocus core business strategy. Lines of business by geography and distribution are being scrutinized and re-evaluated. This examination may guide the divestiture of non-core assets and operations.
Customer preferences and the distribution network

Insurance customer behavior and expectations are in the midst of profound change, driven by new, mobile technological tools and the growth of social media. These societal factors alter how P&C insurers should market, price, sell and service their products, given that internet-based businesses have set new standards for customer-centricity, thereby raising the performance bar for every retail business.

Ernst & Young’s Global Insurance Consumer Survey 2012 explores customers’ attitudes and behaviors, separating myth from reality and providing some hard evidence of what customers want today. The first myth is that the use of internet resources is growing rapidly, and in the future the dominant channel for insurers will be online – for research and transactions. The fact is that only 32% of survey respondents use the internet to research insurance, and only 7% have actually bought insurance through a website. This finding is fairly consistent with US and global results. Nevertheless, 31% of respondents indicated they will use insurance quote comparison websites in the future.

The upshot is that while online channels are an important part of insurance distribution, they are just one component of the insurance sales cycle. Insurers should seek to seamlessly integrate both online and offline channels to meet customers’ needs, as most still prefer to buy insurance through more traditional channels.

Buying insurance is not all about price, either. While critical, other factors like product flexibility, brand positioning, customer segmentation and the simplicity of the sales and renewal processes are very important to customers, according to our survey. Additionally, customers expect a good claims experience. While a good claims experience will not increase loyalty or build brand value, a bad experience will diminish them. Therefore P&C insurers need to ensure that enough focus is placed on the claims experience to maintain the status quo.

Customer service can be a vital competitive differentiator. Understanding that a significant number of customers prefer to buy different products from a single supplier – and are receptive to cross-selling when the insurer understands their needs and offers the right proposition – can guide new business and improve customer retention.

An insurer thus needs to demonstrate to a customer why the purchase of an additional product is a better value than going to another insurer. In this age of loyalty programs and points, customers will expect rewards for holding more than one product. Insurers must develop pricing models that accommodate these expectations.

In this age of technological sophistication, insurers must gauge how current and prospective customers prefer to purchase insurance – through traditional agents and brokers, directly or online – and then invest in the appropriate channels. For example, establishing a sound direct insurance sales cycle may provide an advantage.

The changing demographic of the aging broker channel is another consideration as a new generation of brokers enters the market. Insurers need to determine whether to position themselves to retain and grow their businesses through these new brokers or move instead to more of a direct channel via the acquisition of brokers.
Harnessing data for intelligent underwriting

Canadian P&C insurers have access to a rapidly expanding volume of data from transactions, claim histories, social media connections, internet searches and GPS-based devices. Insurers that are able to harness this vast volume of data may achieve a competitive advantage as they move ahead in their growth strategies.

Integrating and leveraging this data throughout the insurance sales cycle may guide improvements in underwriting capabilities, customer service and even the claims experience. Not that this process is by any means easy – a host of challenges must be overcome to derive meaningful, insightful information for decision-making purposes.

One problem affecting the ability to provide real-time insurance solutions through mobile communications is the current state of insurers’ technology systems. Many insurers are encumbered by legacy systems and associated business processes that need upgrading. Consequently, the prospective return on investment in an updated infrastructure is compelling. Claims and billing services are a focal point, as consumers increasingly look toward technology-driven solutions to improve the insurance service experience.

Data management and analytics have been fundamental elements of insurance operations for decades. There has been exponential growth in the types of useful data available to insurers in recent years, and in the speed with which it is collected. This is the era of “big data” – extremely large and complex data sets that are beyond the ability of traditional database and software tools to house, organize and analyze.

New insights into customer preferences and behaviors can substantially assist insurers’ cross-selling and retention initiatives, while offering new approaches to address claims leakage. The aforementioned vehicle telematics technology hints at the types of data that can be collected and analyzed. While traditional application-based underwriting information provides a snapshot of the risk under consideration, telematics provides a real-time data set with real-time delivery. This increases by an order of magnitude the volume and speed of delivered data.

This underwriting information extends beyond aggregated market data. It includes specific data about individual behavior patterns, thereby expanding pricing possibilities. The technology also gives the claims function the opportunity to record data from accidents as they occur; thus the claims process can begin the instant the event occurs. This, in turn, offers the promise of expedited claim payments, reducing policyholder uncertainty and improving customer satisfaction.
While the automobile lines of business are the initial beneficiaries of big data, opportunities are also emerging in homeowners insurance, via the use of video monitors, security systems and gaming systems that collect and transmit usable data.

Many companies currently lack the necessary technological sophistication to benefit from these efforts. Data integration involving incompatible legacy systems limited early data management initiatives and now threatens to impede analytical advances. To extract meaningful information from big data, insurers must improve their existing data management capabilities. The goal is to integrate data from multiple sources, which are typically housed in various functional areas, for sharing with relevant colleagues across the enterprise.

Another challenge is the shortage of data management talent to pursue these opportunities. While big data presents new operating possibilities, it requires new skill sets in data analysis. Insurers will need to invest in skilled employees who can collect, analyze, disseminate and manage massive volumes of data. Tying this all together will likely require a new set of leadership capabilities, such as the appointment of a chief data officer, a role that is expected to assume greater prominence in the future.

A final concern is privacy. Much of the information gathered is personal. While many people are willing to share personal data in exchange for a benefit, this creates substantial risks for insurers entrusted with guaranteeing the security of this personally identifiable information. As a result, data security involving enhanced governance systems and threat and vulnerability assessment capabilities is increasingly a vital necessity.

The explosion of data opens an array of new areas insurers can mine for competitive advantage. The ability to innovate via big data will be a key differentiator in 2013, but success requires the will to invest in new systems and related upgrades.

The changing regulatory and reporting landscape

Canadian P&C insurers face rising activity in 2013 among regulatory authorities focused on strengthening insurance solvency and corporate governance.

Following its changes to the Minimum Capital Test guideline in 2012, the Office of the Superintendent of Financial Institutions (OSFI) has announced two new initiatives for 2013. The first is the B9 guideline, Earthquake Exposure Sound Practices. The second is the new Corporate Governance guideline.

OSFI released a draft of its Earthquake Exposure Sound Practices guideline in August 2012 and issued the final guideline in February 2013. Given the recent spate of natural disasters around the world, such events arguably pose a significant threat to the financial well-being of many insurers and reinsurers. Through this guideline, OSFI expects insurers to effectively measure, monitor and limit earthquake exposure, in accordance with a prudent risk appetite and risk tolerance. OSFI seeks a more explicit, principles-based approach by companies that insure earthquake-related losses. The guideline introduces best practices, and outlines the role that senior management and the board must play in the oversight of earthquake exposure risk management.
The insurance industry had voiced reservations about the initial draft guideline. For example, the Canadian Institute of Actuaries expressed a concern over the guideline’s Earthquake Reserve Complement (ERC) capital requirements – the difference between the capital requirements and the sum of the reinsurance program and retention. The institute’s issue was that the draft guideline did not take into account the fact that reinsurance is either an event-based or a region-based transaction, whereas the capital requirements are Canada-wide. Meeting a certain threshold across Canada, on average, would therefore require that higher thresholds be assumed for individual regions. Insurers exposed to potential earthquake losses will need to carefully plan and implement these changes when the draft guideline is finalized.

OSFI also published its draft Corporate Governance guideline in August 2012 and finalized it in January 2013. The guideline applies to all federally regulated financial institutions (FRFIs), except for branch operations. With this guideline, OSFI seeks to enhance the effectiveness of the board of directors by clarifying board responsibilities. It also requires the strengthening of risk governance, requiring the development of a “Risk Appetite Framework” to guide risk-taking activities. At present, FRFIs are implementing independent reviews of five key functions: finance, compliance, internal audit, risk and board effectiveness.

The full implementation of the guideline is expected no later than 31 January 2014. In early 2013, OSFI expects FRFIs to conduct a self-assessment of compliance with the guideline and to establish a plan to address any deficiencies. OSFI expects to receive written results of the FRFI’s self-assessments and related action plans by 1 May 2013. The self-assessments are to be retained by the FRFI and made available to OSFI upon request.

While larger insurers are more apt to possess sufficient resources and capabilities to meet these stepped-up requirements, mid-sized and smaller insurers may have more difficulty. Indeed, many companies are rightly concerned that the costs of compliance will exceed the benefits.

Finally, both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board are continuing their work on the insurance contracts projects under International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles. The projects at present indicate that approaches to insurance accounting will change under both standards.

Exposure drafts (re-exposure in the case of IASB) from both bodies are expected in the first half of 2013, with final standards expected in 2014. The effective date will not be before 1 January 2015, and it is likely to be no earlier than 1 January 2016. Some insurers speculate that these standards could arrive as late as 1 January 2018.

Regulatory and accounting changes inevitably affect insurers’ existing processes, controls, resources and technologies. It is important that insurers understand and take into account these challenges as they implement the necessary operational changes to maintain compliance.
Europe
Challenges and opportunities abound
Market summary

European insurers will continue to weather the challenging economic climate in 2013, at a time when they confront the development and implementation of European and national regulations affecting everything from capital and risk management to distribution and product design.

Against this backdrop, European insurers must focus on managing risks to capital and investments, identifying new opportunities for growth, and adapting systems and operations to address these critical challenges. Uncertainty over the timescale for implementation of the new European regime, together with the potential adoption of different aspects of proposed rules in different countries, will lead to differences in implementation across the region.

The macroeconomic environment in 2013 and beyond remains challenging in many European countries and a source of concern for the region’s financial stability. Unease over government debt levels continues, as does political uncertainty influencing markets, despite relatively strong policy responses at the European government level. Overall, the political and economic climate continues to dampen growth prospects in Europe. Nevertheless, there are regional differences, with gross domestic product (GDP) returning to pre-crisis levels in some countries, and a return to recession a continuing threat in many others.

In these turbulent macroeconomic times, European insurers face key challenges such as the potential impact from sovereign debt defaults and recession-driven declines on the asset values supporting insurers’ liabilities on the equity market. Additionally, a prolonged period of low interest rates will affect the financial resilience of life and non-life insurers, as they struggle to maintain pricing margins and limit the impact on capital and reserves. In this environment, some insurers may seek to increase product prices, which may affect consumer behavior in terms of the quantity and type of insurance products they purchase.

As insurers address these economic challenges in 2013, they will assess their systems and operations in response to a variety of new regulations. Affected areas range from solvency to financial reporting and distribution, and many insurers continue to both understand and prepare for the impact of these regulations.
The impact of Hurricane Sandy on the European insurance industry has yet to be fully understood. While it may harden rates, it will also produce big losses for European insurers writing US business – direct or reinsurance. At present, the storm has caused US$50 billion of losses, of which insurers are expected to pay out approximately US$20 billion.

In this tumultuous environment, European insurers will need to:

- Focus on customer growth opportunities in a low-growth region
  - Focus on customers’ needs
  - Appreciate the sharpened regulatory focus on consumers
- Protect and strengthen the investment portfolio
- Ensure capital adequacy
- Finalize the testing and integration of Solvency II systems
- Prepare and respond to developing regulation
- Consider tax changes that are ahead
- Anticipate upcoming non-bank recovery and resolution planning

**Focus on customer growth opportunities in a low-growth region**

In 2013, European insurers will increasingly focus on customers as they seek to improve premium retention and growth. Regulatory changes aimed at improving customer transparency about products and costs will sharpen this focus, guiding successful insurers to re-evaluate their business models and selling propositions. This re-evaluation will cause many insurers to alter distribution, products and services – for example, shifting away from offering investment-linked options and emphasizing protection and customer service. For some insurers, this will be a radical but necessary transformation to generate growth. At the same time, Solvency II will pressure insurers to develop and market more products that shift risk to the insured, rather than being retained by the insurer.

At first glance, the European Union (EU) appears to offer limited organic growth opportunities for life and non-life insurers. European life and non-life premium growth has been lower than in Africa, Asia and Latin America and mixed by comparison with North America. Europe nonetheless remains home to more than 550 million consumers, with a significant need for life insurance and non-life-insurance products. Even though some insurers are looking at “greener” pastures in developing markets, European insurers remain committed to their region. Successful insurers will improve premium growth by identifying and developing new products and services that deepen existing client relationships while attracting and retaining new clients.
Focus on customers’ needs

Ernst & Young’s 2012 Global Insurance Customer Study (Voice of the customer) indicated that among European life consumers, the internet has furthered their ability to compare products and prices and obtain independent opinions before purchasing, even if they use an advisor to complete the purchase. At the same time, the survey found that consumers are willing, and indeed prefer, to buy products from companies they trust and make the purchasing process convenient. Nevertheless, they see the life insurance industry as lagging other sectors, with regard to service delivery and rewarding loyalty.

A strong message for insurers in 2013 is to provide consumers with simpler, more transparent products and the information they need to make informed decisions before purchasing. Insurers also must build trust by delivering a great customer experience while responding to their evolving needs throughout the life cycle. Finally, they need to reward customer loyalty, either when offering additional products or attempting to retain customers.

For non-life insurers, the survey revealed that European insurance consumers are driven by convenience and value. Convenience involves the ability to research and buy when they want. This, in turn, has driven the growth of provider direct and third-party online websites. Value is more than just offering the lowest price; consumers also are looking for a combination of product, service and price that meets their needs. The challenge facing non-life insurers is that convenience and value vary across markets and consumer segments.

As a result, non-life insurers in 2013 need to meet diverse customer needs by integrating online and offline communication channels to streamline both sales and back-office functions. New sales and renewal processes must be made simple and convenient for customers across whichever channel or medium they select. Finally, since dissatisfied consumers can easily and widely voice their complaints on the internet, possibly disrupting new sales potential and existing relationships, insurers must seek to develop, manage and protect their brands in the digital world.

Thanks to the internet, both life and non-life insurers are under increasing pressure to meet changing consumer demands on a 24/7/365 basis. The speed of information sharing among insurers, distributors and consumers places a strategic advantage on robust, integrated back-office systems that reduce or eliminate dataflow roadblocks and checkpoints.

Insurers will further benefit by improving their ability to organize and sift through increasing amounts of data to better understand and target customers. The increasing use of consumer analytics provides a competitive advantage by identifying the most profitable customer segments. The problem for insurers is that consumer data often resides in disparate product administration systems and formats. The challenge, then, is to efficiently organize and extract meaningful information from these systems.
Emerging consumer regulations are sharpening the focus on value for money and suitability, challenging traditional pricing, incentives and distribution models. In response, insurers need to better understand the end customers’ needs, simplify product offerings and offer true multichannel access – according to the ways in which customers want to interact.

Bancassurance as a distribution model may need to reinvent itself as regulations unbundling banking products and insurance products are implemented. Without a bundled sale, bancassurers need to be more focused on customer needs. A key aspect of this shift involves developing a deeper understanding of customer profitability when insurance sales are separated from banking transactions. Some bancassurers may re-evaluate their business model and consider separating their banking and insurance operations.

In 2013, insurers also will be adjusting to the European ban on gender-based pricing, which will increase the cost of insurance across life and non-life products. For motor insurers, a growing value-added service is increasing the use of telematics. While initially viewed as expensive technology, the ability to use telematics to price motor insurance on individual driving behavior may help avoid the significant increases in women drivers’ premiums, which could result in the loss of business. During 2013, insurers considering the use of telematics need to understand how its adoption may be affected by sales via internet aggregators. Additionally, insurers considering implementing a telematics solution need to evaluate the demands it would place on IT, especially in the areas of data security and processing.
European regulations will continue to have an important strategic and operational impact on insurers. In the retail market, the Markets in Financial Instruments Directive (MIFID II), Packaged Retail Investment Products (PRIPs) and Insurance Meditation Directive (IMD) will all be on the agenda of the European Parliament in 2013. European life insurers also need to prepare for the implementation of the PRIPs initiative in 2014, although many details remain to be debated and finalized. PRIPs will require insurers to provide a Key Information Document to consumers prior to their purchase of a policy. In 2013, insurers must analyze their product portfolios to identify the products affected by PRIPs and prepare for the necessary operational changes this requires. The level of change will vary by country, depending on the level of existing local disclosure requirements.

Similarly, proposed revisions to the IMD, which is not likely to be finalized and implemented until after 2015, may challenge existing distribution models while creating opportunities to develop new models. In this environment, fast-moving insurers that identify and respond to these challenges and opportunities are better positioned to profit in a more transparent and level distribution environment.

The European Commission (EC) has proposed revising the existing IMD, which regulates selling practices for all insurance products, from general insurance products like motor and household insurance to those containing investment elements. The revisions seek to improve transparency and establish a level playing field for insurance sales by intermediaries and insurance companies. Again, the level of change will vary by country, depending on existing regulations. The proposals will be debated during 2013, and a key area of interest will be discussions regarding commission disclosure, the degree to which this applies to insurers and – critically – how it will apply to insurance companies which do not pay commission, such as direct writers. The proposed ban on product tying also could have a significant strategic impact on the industry.
In 2013, continued pressure on margins is anticipated, caused by the prolonged low-interest-rate environment and ongoing uncertainty surrounding sovereign debt. This will compel insurers to choose a combination of solutions to improve portfolio returns while further derisking their investment portfolios. Such combinations will involve sovereign debt holdings reductions, asset-to-liability duration matching improvements, hedging strategy refinements, and the seeking of higher returns in potentially riskier asset classes.

European insurers have taken steps to limit their exposure to sovereign debt of fiscally challenged countries. Domestic insurers are at greatest risk as they continue to retain substantial holdings of sovereign government debt. The retrenchment from holding the debt of Europe’s fiscally challenged countries represents a change. The policy a few years ago was to diversify from home-country concentration to embrace a more diversified European portfolio. Several European insurers have trimmed their GIIPS (Greece, Ireland, Italy, Portugal, Spain) holdings in 2012 to favor lower-risk issues. Moving toward lower-risk assets, of course, means accepting lower returns on these assets. As a result, insurers will need to balance risk and return. This may lead some insurers to continue holding some GIIPS sovereign debt because of the higher returns it may produce.

European insurers will continue to refine their asset liability management (ALM) in 2013, as many still have asset durations several years short of accompanying liabilities. Improving asset liability matching will require insurers to lengthen the duration of some fixed-income securities. Lengthening the durations may increase credit risk, however. Additionally, the availability of quality long-duration assets may be limited. Insurers thus need to balance improvements in ALM against the challenges. Insurers not wishing to lengthen the asset duration may use derivatives as an alternative, although this option can create counterparty exposures and liquidity requirements that must be managed. Finally, since cutting exposure and hedging against adverse developments do not tend to boost returns, some insurers may take on more investment risk.

Effectively increasing investment returns requires expenditures in investment risk management, access to a variety of asset classes and markets, and an understanding how the risks in these asset classes and markets affect the overall level of risk borne by the company. A key influence on an insurer’s risk appetite will be the treatment of various asset classes like real estate investments under the existing Solvency I and the proposed Solvency II, as well as an insurer’s own view on the inherent riskiness of particular assets. Larger insurers may gain a strategic advantage over smaller competitors, both in terms of access to certain classes of asset and in investment risk management systems.

The European Insurance and Occupational Pension Authority reported in its mid-2012 report on European insurance that while life insurers are examining how to reduce the capital strains caused by guaranteed products, the prolonged low-interest-rate environment will depress the yields available for new business. If price rises are deemed unattractive to customers, an increasing focus on marketing unit-linked and reduced-guarantee products is anticipated.

**Protect and strengthen the investment portfolio**

In 2013, continued pressure on margins is anticipated, caused by the prolonged low-interest-rate environment and ongoing uncertainty surrounding sovereign debt. This will compel insurers to choose a combination of solutions to improve portfolio returns while further derisking their investment portfolios. Such combinations will involve sovereign debt holdings reductions, asset-to-liability duration matching improvements, hedging strategy refinements, and the seeking of higher returns in potentially riskier asset classes.

European insurers have taken steps to limit their exposure to sovereign debt of fiscally challenged countries. Domestic insurers are at greatest risk as they continue to retain substantial holdings of sovereign government debt. The retrenchment from holding the debt of Europe's fiscally challenged countries represents a change. The policy a few years ago was to diversify from home-country concentration to embrace a more diversified European portfolio. Several European insurers have trimmed their GIIPS (Greece, Ireland, Italy, Portugal, Spain) holdings in 2012 to favor lower-risk issues. Moving toward lower-risk assets, of course, means accepting lower returns on these assets. As a result, insurers will need to balance risk and return. This may lead some insurers to continue holding some GIIPS sovereign debt because of the higher returns it may produce.

European insurers will continue to refine their asset liability management (ALM) in 2013, as many still have asset durations several years short of accompanying liabilities. Improving asset liability matching will require insurers to lengthen the duration of some fixed-income securities. Lengthening the durations may increase credit risk, however. Additionally, the availability of quality long-duration assets may be limited. Insurers thus need to balance improvements in ALM against the challenges. Insurers not wishing to lengthen the asset duration may use derivatives as an alternative, although this option can create counterparty exposures and liquidity requirements that must be managed. Finally, since cutting exposure and hedging against adverse developments do not tend to boost returns, some insurers may take on more investment risk.

Effectively increasing investment returns requires expenditures in investment risk management, access to a variety of asset classes and markets, and an understanding how the risks in these asset classes and markets affect the overall level of risk borne by the company. A key influence on an insurer’s risk appetite will be the treatment of various asset classes like real estate investments under the existing Solvency I and the proposed Solvency II, as well as an insurer’s own view on the inherent riskiness of particular assets. Larger insurers may gain a strategic advantage over smaller competitors, both in terms of access to certain classes of asset and in investment risk management systems.

The European Insurance and Occupational Pension Authority reported in its mid-2012 report on European insurance that while life insurers are examining how to reduce the capital strains caused by guaranteed products, the prolonged low-interest-rate environment will depress the yields available for new business. If price rises are deemed unattractive to customers, an increasing focus on marketing unit-linked and reduced-guarantee products is anticipated.
Ensure capital adequacy

In 2013, European insurers must continue to review and refine their capital management strategies to be Solvency II-ready, as well as to optimize their balance sheets and appropriately redeploy capital. Sound capital management strategies can bolster the appeal of the insurance sector to investors who wrongly view insurers and banks through the same lens, often failing to appreciate insurers' stronger operating fundamentals and much lower liquidity risk.

Full implementation of Solvency II by 1 January 2014 appears completely unrealistic to regulators and the industry alike. To resolve the remaining key technical issue, many insurers will be required to participate in the Long Term Guarantees Impact Assessment during Q1 2013. In some European countries, insurers also must respond to further information requests during the year, providing their Solvency II capital positions to regulators and accelerating the need to manage these results alongside existing Solvency I capital.

The transition to a more risk-sensitive regulatory regime will foster potentially higher capital requirements for some forms of guaranteed benefits, as well as increased capital costs for certain risk exposures. These unfolding requirements, combined with the strains from Eurozone sovereign debt, low interest rates and low investment yields, are driving insurers to take bold moves to improve capital management. These include enhancing asset liability management, using reinsurance as a capital management tool, spinning off entire entities or shedding underperforming units, and evaluating whether alternative domiciles might offer better capital treatment with respect to non-European business.

As insurers evaluate the ways in which reinsurance can be a tool for effective capital management in 2013, they must also be aware of the changing nature of reinsurance, both in terms of the available products and Solvency II requirements to fully assess and reflect a cedent's counterparty risk exposure to the reinsurer. In addition to traditional quota share and excess of loss arrangements, new capital market alternatives to traditional reinsurance are available. These include collateralized reinsurance and burgeoning products in the insurance-linked securities market, which are especially valuable for cedents seeking to reduce their exposure to capital-consuming low-frequency/high-severity property or liability loss events.

In 2013, insurers must take actions to allocate capital optimally and to support the product mix and their geographical footprint. Capital diverted from lagging operations will need to be deployed in regions and products with brighter prospects. Numerous European insurers have looked to Asia and other high-growth emerging regions, such as Latin America, for future premium growth. Within Europe, life insurers will need to consider how much capital to allocate to the products likely to grow in demand in an aging population, such as savings, longevity and long-term-care products.
Finalize the testing and integration of Solvency II systems

While the EC continues to determine the implementation date for Solvency II, insurers in 2013 must focus on finalizing the necessary capabilities to comply with Solvency II's requirements, among them Pillar 3. The consequences of errors or omissions in Pillar 3 reports may result in more reworking of data gathering and calculations or, in extreme cases, result in capital add-ons to solvency capital requirements regardless of the status of other pillars. Successfully demonstrating the embedding of reporting requirements into a business-as-usual environment and implementing Pillar 2 under the existing timelines will remain a significant challenge. Insurers need to be adaptable and ready to deliver the key reporting solution that Pillar 3 presents to their organizations.

In terms of preparation, some insurers are more advanced than others. Ernst & Young's Solvency II 2012 survey found that for those insurers that had completed an initial Pillar 3 gap analysis, 2013 will be a year of testing systems and gaining confidence in the successful integration and embedding of these regulations into regular operational processes.

For insurers kicking off their Pillar 3 analysis, 2013 will be a year of catching up. This may affect their overall profitability as project expenditures increase to bridge the gap and money is spent to secure the best available talent and resources. The issues described above provide some indication of the breadth and depth of the challenges late-starting insurers may face. Meeting these challenges will likely be costly to financial, human and system-related resources.

For all insurers, the costs associated with these regulatory changes will affect their corporate income statements and disclosures. As a result, insurers must be prepared to answer detailed stakeholder questions about their preparations for the regulatory changes and the rising costs associated with them.
Prepare and respond to developing regulation

With European sovereign debt issues continuing to dominate the macroeconomic agenda and the implementation date for Solvency II being postponed once again, insurers nonetheless cannot afford to reduce their focus on the implementation activities related to future regulatory and financial reporting changes.

Despite the postponement, a convergence is likely between the implementation dates for Solvency II reporting and the financial reporting changes represented by International Financial Reporting Standards (IFRS) 4 Phase II increases. For insurers grappling with the major challenges these initiatives convey, the delay presents a perfect opportunity to step back, think strategically and carve a competitive edge. For example, companies may transform the way they produce and use data or assist Finance to add greater value.

Both IFRS 4 Phase II and Solvency II involve fundamental changes and significant delivery challenges for insurers. With regard to the latest implementation date for Solvency II, it appears most likely at present to become effective in 2016. In parallel, insurers are preparing for changes to both asset accounting under IFRS 9 and liability accounting under IFRS 4 Phase II. IFRS 9 is expected to be implemented by 1 January 2015, while IFRS 4 Phase II is likely to have an effective date between 2017 and 2018.

Until now, the data required for implementing Solvency II, and for reporting under Pillar 3, seemed likely to be required well before the implementation of IFRS 4 Phase II. As such, it has made sense for organizations to prioritize Solvency II, thereby deferring any significant work on IFRS 4 Phase II until more clarity is provided on the implementation date.

As the expected implementation timing of the two measures becomes increasingly aligned, insurers have a real opportunity to take stock and look closely at how they are addressing their implementation, especially with regard to data, systems and processes, i.e., to address system and data matters in one initiative.
Consider tax changes that are ahead

Tax legislation is a moving target, with governments drafting and redrafting tax laws. These aim to raise new revenue streams, erase a perceived abuse or make one territory more attractive for taxpayers than another. The current economic environment across the Eurozone, EU and other parts of the world appears to have increased the volume of tax law change globally. Consequently, insurers must keep abreast of evolving developments and adjust their business models accordingly.

Tax change affects every aspect of an insurer’s business. The taxation of a company’s profit is usually the main area of focus, but personal tax changes in some countries could affect the nature of the policies written. Customers demand different attributes in their insurance and investment products, and the increasingly changing nature of these products may affect an already-stressed investment return.

Insurers’ top-line results are likely to feel the impact of changing tax regulation, such as financial transaction taxes in France and Spain, withholding tax rates in Portugal, and the emergence of global reporting and withholding obligations imposed by some countries on their citizens located abroad, e.g., the Foreign Account Tax Compliance Act (FATCA) in the United States.

With regard to possible exposure to FATCA, European life insurers will need to review their customer and investment accounts in 2013. FATCA regulation is designed to counter offshore tax avoidance by US citizens who have invested outside the country in cash-value life insurance contracts, equity or debt securities, or any depository or custodial accounts. European insurers should accelerate their impact assessment activities. This includes developing an implementation plan to perform account due diligence on pre-existing accounts, revising account holder identification and onboarding processes, and designing new information reporting and withholding procedures. Each of these activities will require meaningful changes in business processes, as well as technology support.
In February 2012, a joint statement was issued by the US, France, Germany, Italy, Spain and the UK. It described a possible framework whereby foreign financial institutions would report required FATCA information to their local tax authorities. This, in turn, would be provided to the US under exchange provisions, tax treaties or other information exchange agreements. In September 2012, the UK and US became the first parties to conclude an intergovernmental agreement. It is understood that US authorities are concluding similar agreements with up to 50 other partner countries. Thus, it is highly probable that multinational groups operating throughout the world will need to comply with FATCA in different ways, depending on the various jurisdictions in which they operate. This may increase compliance costs and better coordinate reporting.

The manner in which companies arrange their tax affairs across their global group is under a great deal of scrutiny in certain countries. Much of the focus has been around the organization of their supply chain within the group – where functions are carried out or where services originate. Most countries have transfer pricing rules as part of their tax regime. The principle behind transfer pricing is that transactions between connected parties must be concluded at an arm’s length rate, i.e., what a third party would charge for the same service or product.

When elements of a group’s supply chain are in different countries, this may lead to an allocation of business profits across the world. Where parts of the profits arise in countries with lower tax rates, groups are being challenged through public opinion or fairness. Any company could face enhanced scrutiny as a result of its transfer pricing policy and global operating model. Therefore, the senior executives trading or organized globally should be aware of this additional level of focus. They should also be prepared, if needed, to support their position and justify the manner in which they organize the company’s affairs. Robust transfer pricing policies and documentation are an absolute must, but a plan of response may also be a good idea.

Clearly, complying with global taxes is becoming more complex. Given the significant cost of tax to business, implementing measures that drive tax efficiency will increase in importance.
Anticipate upcoming non-bank recovery and resolution planning

After a pronounced scrutiny of banks, regulators are beginning to turn their attention to insurers with regard to their recovery and resolution plans in cases of severe distress, thereby enabling an orderly liquidation of the institution with limited impact on retail customers or the global financial system.

At a global level, The International Association of Insurance Supervisors (IAIS), under the tight reins of the Financial Stability Board (FSB) and the watchful gaze of the G20, is assessing 48 insurers for systemic risk across five key factors – size, global activity, interconnectedness with the financial markets, ease of substitutability of cover, and non-traditional and non-insurance activity.

In less than three months, the IAIS will deliver a list of global, systemically important insurers (G-SIIs) to the FSB, and in April 2013, this list will be published. The G-SIIs will be required to submit detailed recovery and resolution plans and systemic risk reduction plans.

To date, reactions from insurers have been mixed. While a few insurers oppose the prospect of more regulatory pressures, others recognize that their global size, reach and diversification have contributed to the tighter regulatory approaches. For some insurers, there are obvious strategic opportunities to position their products as recovery solutions for other insurers. Despite these differences in view, those insurers that believe they will be designated a G-SII, or think they are on the cusp of this designation, are gearing up and forming programs now, ahead of the first cohort of G-SII designations expected by April 2013.
Once the April 2013 designation is announced, insurers will have 18 months to complete a recovery plan, a resolution plan and a systemic risk reduction plan. These will be challenging for most insurers under the current proposals. Implementation of the systemic risk reduction plan may include restructuring, and improving of liquidity planning and governance. Insurers expecting to be designated as G-SIIs must plan now for the necessary actions.

The EC is currently considering its approach to systemic risk in non-banking financial institutions, such as insurance. National policymakers also are paying greater attention to this area. Even if an insurer is not designated G-SII, regional or national supervision still means it must contemplate its potential failure. Regulators are likely to require evidence of credible planning covering core business units and jurisdictions. Developing a consolidated approach that addresses global, regional and national systemic risks indicates the impact on insurers will be substantial. Insurers must look at the contingency plans they have in place and make them more robust, identifying the risks and dependencies to which they are subject, the available options and necessary decisions.

While all the work already completed with respect to programs such as Solvency II preparation and enterprise risk management (ERM) provides many groups with a good foundation for recovery and resolution planning, the exercise is far from trivial, not least given the complexity of insurance regimes in many countries and the degree of connectivity in some insurance groups. Banks have found that addressing these areas requires the involvement of many specialist skills and needs sponsorship from the top. This is hard to achieve when many countries are evolving their insurance regulation. However, the greater risk to insurers in the next few months is not engaging with the process on a timely basis and at a sufficiently high level.
Latin America

Poised for growth
Market summary

The Latin American insurance market is poised for continued growth in 2013. Furthermore, the effects of globalization continue in the region, evidenced by business expansion and an uptick in mergers and acquisitions, both requiring greater global insurance capacity and risk modeling. Forecasts for mid-single-digit real economic growth rates across the region contrast with expected conditions elsewhere in the world. In addition to economic expansion, opportunities exist for insurers to improve chronically low market penetration rates by tapping the growing middle classes and consumer markets.

Innovations in distribution and product development, and effective use of technology, can guide sustainable growth for successful insurers. As investment returns narrow, the focus on technical underwriting returns requires improvements in operational performance and analytic capabilities to drive risk-based capital management. Many insurers will need to transform their legacy systems to support data analysis across the value chain. Efficient and transparent capital management that precedes regulatory directives also can be a strategic advantage in a generally opaque operating environment, such as the present one.

Successful investment in Latin America requires a nuanced understanding of the complex economic, competitive and regulatory conditions across the region. Flexibility, innovation and strategic alliances can enhance both market positions and technical strength.

Ernst & Young believes the following pursuits are critical in these growth markets:

- Capitalizing strategically on substantial compound growth opportunities
- Expanding markets through innovation directed by local expertise
- Exploiting advantages from competencies in technologies
- Proactively integrating advanced risk/capital management and transparency with regulatory reforms
- Expanding and enhancing catastrophe risk markets
1. Capitalize strategically on substantial compound growth opportunities

With more than 550 million people, and nearly US$130 billion in annual insurance sales, compound growth is the central attraction of Latin American insurance markets. Conditions at the end of 2012 indicate higher growth compared with mature US and Eurozone economies. Emerging middle classes in Brazil, Mexico and other Latin American countries present opportunities for sustainable premium growth. Challenges include competition with entrenched distribution channels; varying economic, regulatory and political environments; and the pace of consumer and business market change. Strategic rather than broad-based approaches to these markets are advisable.

Brazil's economy is booming. Ernst & Young's 2012 survey of investors cited Brazil as the country with the most economic potential in Latin America, with more than four-fifths of respondents anticipating that opportunities will increase in the next three years. Approximately 2.7 million Brazilians moved into the middle class in 2011, and estimates indicate that 40 million people have gone from living in poverty to the middle class in the past decade. These consumers are accumulating assets, like homes and automobiles, requiring insurance protection.

Surveys indicate that the emerging middle class is also investing in education and savings. Brazil's relatively stable inflation rate – generally below 10% for the past 15 years – supports this shift. This is a far cry from the annual inflation rate of 100% to more than 4,000% in the 1980s and much of the 1990s, rendering financial planning unreliable.

Fifty percent of Mexico's population has also entered the middle class, compared with 80% of its population being impoverished in 1960. Economists and business analysts associate the recent growth in Mexican consumption and post-secondary-school education enrollment with the social goals of this emerging middle class.

### Latin American economic and insurance data

<table>
<thead>
<tr>
<th>Region country</th>
<th>Real GDP growth estimate 2012*</th>
<th>Real GDP growth forecast 2013*</th>
<th>Consumer inflation</th>
<th>Life insurance premium 2012+ (est.) USD billions</th>
<th>Non-life insurance premium 2012+ (est.) USD billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America</td>
<td>4.00%</td>
<td>4.00%</td>
<td>4.00%</td>
<td>$48</td>
<td>$73</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.50%</td>
<td>4.00%</td>
<td>4.90%</td>
<td>$28</td>
<td>$23</td>
</tr>
<tr>
<td>Chile</td>
<td>5.00%</td>
<td>4.10%</td>
<td>3.00%</td>
<td>$5</td>
<td>$3</td>
</tr>
<tr>
<td>Colombia</td>
<td>4.20%</td>
<td>4.40%</td>
<td>2.80%</td>
<td>$2</td>
<td>$5</td>
</tr>
<tr>
<td>Mexico</td>
<td>3.80%</td>
<td>3.50%</td>
<td>3.50%</td>
<td>$9</td>
<td>$10</td>
</tr>
<tr>
<td>Argentina</td>
<td>2.60%</td>
<td>3.10%</td>
<td>9.70%</td>
<td>$1*</td>
<td>$7</td>
</tr>
<tr>
<td>Venezuela</td>
<td>5.70%</td>
<td>3.30%</td>
<td>28.80%</td>
<td>$200</td>
<td>$8</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>0.90%</td>
<td>1.10%</td>
<td>3.20%</td>
<td>$1</td>
<td>$10</td>
</tr>
</tbody>
</table>

*International Monetary Fund, except Commonwealth of Puerto Rico projections

+Estimated from the latest available data provided by the individual countries' insurance supervisory organization
Latin American countries have relatively youthful populations. This presents potential for greater asset growth and compound sales over the life spans of these consumers. More than 25% of the populations in Brazil, Mexico, Colombia and Argentina are under 15 years of age, and less than 7% of the populations in most Latin American countries are over 65 years of age. Insurers can solidify their branding positions with these new insurance customers without the need to dislodge them from competing providers.

### Latin American population data

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (millions)</th>
<th>Forecast population growth rate for 2012</th>
<th>Percentage of population in under 15 years old</th>
<th>Percentage of population more than 65 years old</th>
</tr>
</thead>
<tbody>
<tr>
<td>Venezuela</td>
<td>29</td>
<td>1.47%</td>
<td>29.00%</td>
<td>5.60%</td>
</tr>
<tr>
<td>Colombia</td>
<td>42</td>
<td>1.13%</td>
<td>26.20%</td>
<td>6.30%</td>
</tr>
<tr>
<td>Brazil</td>
<td>200</td>
<td>1.10%</td>
<td>26.00%</td>
<td>6.90%</td>
</tr>
<tr>
<td>Mexico</td>
<td>115</td>
<td>1.09%</td>
<td>28.20%</td>
<td>6.60%</td>
</tr>
<tr>
<td>Argentina</td>
<td>42</td>
<td>1.00%</td>
<td>25.20%</td>
<td>11.10%</td>
</tr>
<tr>
<td>Chile</td>
<td>17</td>
<td>0.88%</td>
<td>21.40%</td>
<td>9.40%</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>4</td>
<td>0.24%</td>
<td>18.40%</td>
<td>15.60%</td>
</tr>
</tbody>
</table>

Source: Central Intelligence Agency World Fact Book

Note: For comparison, the percentages of the US and German populations under 15 are 20% and 13%, respectively; over 65 are 13% and 21%, respectively.
Successfully developing these markets requires knowledge of the region’s varying cultures and dynamic regulatory and political environments. Ernst & Young’s 2012 global customer survey identified vast differences in Brazil and Mexico insofar as the use of online comparisons of life and investment products, with Brazilian use significantly higher. Many Latin American countries have strong high-speed internet penetration rates and social networking use. Chile, for instance, has one of the highest internet penetration rates in the world. Online aggregators/comparison sites have started up in the country and also in Brazil. If product comparisons trend more toward internet channels, as in Europe, this could cause a major shift in insurance distribution.

Consumer protection authorities across the region are focusing more on insurance and related pricing, commissions and customer rights. In Chile, SERNAC (Servicio Nacional del Consumidor) ruled that mortgage-related insurance from banks must involve an organized, regulated bidding process. This has increased competitive pricing and created the need for differentiated products.

These various factors are contributing to the development of two insurance markets—established domestic insurers with entrenched distribution and firm commercial relationships, and established international players with scale and technical sophistication. Among the 25 largest insurers in Latin America, the subsidiaries of international insurers account for roughly half the premium volume. Despite UnitedHealth’s purchase of Amil Participacoes of Brazil (for nearly US$5 billion), rapid expansion by international insurers is difficult. Obstacles include regulatory and government actions that appear to favor local protectionism and the threat of losing talent post-acquisition.

Disparate political environments are another key factor to consider. Argentina has nationalized reinsurance and forced repatriation of assets for life insurers. Brazil may create state-owned commercial insurers, and Chile has privatized life insurance and appears committed to achieving Solvency II equivalence.

Despite these obstacles, insurers in Latin America have the opportunity to build compound growth in both the life and non-life sectors.
2. Expand markets through innovation directed by local expertise

To successfully penetrate Latin American markets, insurers should recognize the need to improve cost efficiencies and respond to emerging customer preferences through innovation in distribution and product development.

Strongly entrenched insurer-distribution partnerships challenge new market entrants, as well as strategies to expand market share. Since market penetration is substantially less than in developed countries, insurers confront high distribution costs and the need to educate new customers about insurance. Encouraging signs include consumer embrace of new distribution channels and wider use of the internet and social media. Regulatory changes also favor development of competitive efficiencies.

### Latin American insurance innovation

<table>
<thead>
<tr>
<th>Condition</th>
<th>Innovative objective</th>
<th>Solution examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited customer reach</td>
<td>Convenient access</td>
<td>Travel insurance via travel agent</td>
</tr>
<tr>
<td>Low insurance perception</td>
<td>Informed customer market</td>
<td>Micro-insurance products</td>
</tr>
<tr>
<td>Rising globalization and trade</td>
<td>Cross-regional risk management</td>
<td>Customized capital and risk management products</td>
</tr>
</tbody>
</table>
Understanding customer behaviors can guide new and expanded systems for insurance product distribution. Consumers in Colombia spend an average of 8.4 hours per month on social networks, compared with an average of 7.1 hours in the UK. As insurance penetration increases, entrenched distribution models will be pressured to increase efficiency and address consumer preferences, creating opportunities for innovative distribution models. Insurers can reverse the “top-down” business model, where companies create products and then consumers respond to them.

More lower-income clients are using voluntary insurance products thanks to regulatory changes to accommodate micro-insurance. In Brazil, SUSEP (Superintendência de Seguros Privados) has promoted micro-insurance with simplified product approval processes and contract flexibility. SUSEP has also issued circulars on new distribution channels, micro-insurance brokers and insurance purchases through “bihetes” (tickets). Regulators are allowing the use of smart cards and electronic debit cards for premium collection, promoting partnering with other financial transactions to reduce costs and increase the ease of insurance transactions.

The expansion of micro-insurance also enhances consumer trust. Research indicates wide belief among individuals without insurance that it is very expensive, whereas current policyholders are fully cognizant of the value of insurance.

Corporate growth and expanding global trade also increase the need for global insurance capacity. Colombia, for instance, has engineered free trade agreements with the world’s major markets, guiding large increases in advertising and branding. Similarly, 90% of Mexico’s trade is now under free trade agreements. Since the implementation of NAFTA (North American Free Trade Agreement) in 1994, Mexico’s share of US imports has increased from 7% to 12%, and its share of Canadian imports has doubled to 5%.

As local businesses compete on a broader scale, they are exposed to complex supply chain and reputational risks that traditional insurance products do not currently address. To provide unique risk transfer and capital management solutions, insurers must have a deep understanding of Latin American business dynamics.
3. Exploit advantages from competencies in technologies

Investment returns are decreasing and squeezing margins in Latin America and elsewhere in the world. In Brazil, average yields fell from 5% to an annualized interest rate of near 2% because the government required banks to reduce spreads. This, in turn, affects insurer business models, product development strategies and investment strategies. Consequently, leading insurers are implementing clearer risk appetite measures and reinforcing their internal audit, actuarial and risk management functions. Many are also investing in technologies across multiple fronts to achieve process efficiencies, improve underwriting and claims analytics, and target profitable customer segments.

High-growth Latin American insurance markets require significant insurer operational capacity and efficiencies. Improving the customer experience is increasingly important, given the growing middle class and insurer competition. Unfortunately, many insurers are burdened by legacy information technologies (IT) systems with inferior policy and claims processing, as well as inadequate data granularity and reliability to support advanced predictive analyses. As insurers build internal support for analysis-based competition, opportunities to move beyond traditional products to become strategic partners with technology resources will emerge.

Insurers need more detailed and reliable information internally to manage their businesses and must incorporate a wider range of external sources. This requires transforming existing multiple legacy systems to provide greater speed, flexibility and transparency or investing in new IT systems and upgrades.

The use of telematics, social media and mobile communication can widen customer data sources and opportunities. In Brazil, Law Contran 245 supports use of telematics, requiring new vehicles to be equipped with tracking modules. Ultimately, this will expand vehicle tracking beyond the current use for high-end vehicles and high-value cargo. Social media and other internet strategies can also reach new customers efficiently through personalized communications.

Opportunities to achieve greater marketing and financial returns from data analysis will require investments in technology to enhance data quality and granularity. While transitioning from legacy systems is a momentous step, access to necessary expertise and experience is equally critical. Global insurers with experience using predictive analytics appear to be better positioned to develop these capabilities. Differences in data consistency and breadth, and changes in underlying risk exposures throughout the region, require deep knowledge of these conditions when analyzing statistical findings.
4. Proactively integrate advanced risk/capital management and transparency with regulatory reforms

As solvency regulation develops throughout Latin America, sound and transparent risk management can be a competitive advantage. In this regard, enterprise risk management (ERM) can assist the development of an insurer’s capital management execution and strategic value proposition.

Insurance regulators and insurers in Latin American countries are at different levels of sophistication, capabilities and structure. Many countries, such as Brazil, Mexico and Chile, are moving toward stricter risk-based capital measurements. Brazilian insurers adopted International Financial Reporting Standards (IFRS) as the guiding accounting standard in 2010, and its regulators appear to be pursuing risk-based capital. Proposals on the table include standard formulas for capital charges based on operational risk, enterprise governance, and Own Risk and Solvency Assessment-like regulations. Demand for improved ERM is increasingly on the agendas of regulators and insurers. These varying developments are driving sharper competition and industry consolidation.

Stricter solvency requirements in Mexico address effective internal control, audit and actuarial functions. A new regulatory system slated to become effective in 2014 is based on risk management and implements Solvency II-type concepts and principles. Large insurers preparing for the new regulation have indicated caution on where and how much to invest. Chilean regulation is moving toward risk-based capital requirements and Solvency II. Limited availability of insurance talent and data granularity will slow these developments, although regulators affirm their intent to reward insurers with stronger risk management practices by reflecting this in their capital requirements.

Argentine’s insurance regulatory agency has addressed Solvency II’s capital measures only superficially. The current solvency system is based on traditional methods and is not sensitive to risk or types of insurance. Nationalization of the Argentine life and pension markets reflects a broader relationship of government to business than the country’s commitment toward regulatory effectiveness and Solvency II principles.

While many industry leaders and regulators assert effective capital governance, evidence is often a test of faith, and lack of capital transparency remains an issue. Transparency is an essential prerequisite of a free, efficient market – critical for investors, customers and reinsurers. In this opaque environment, open, verifiable disclosure policies and capital positions increase trust and can be a strategic advantage, not to mention the right business decision. Even disclosures of inadequacies reveal a commitment to repair them.
Sophisticated applications of risk and capital management may be the best long-term strategy to carve out a competitive edge in traditional markets and expand into new ones through innovation. Challenges include insurers’ ERM frameworks, legacy data that may be inadequate or inappropriate for many analytic applications, and dynamic social and economic conditions reducing the effectiveness of models and increasing the risks of model failure. Other challenges include inconsistent data and risk assumptions and the need for vetting standards to assess new sources of data-like mobile interactions. Innovations in products and expanded distribution may create analytic distortions, requiring conservative analytic decision making and reassessment of model failure risk.

ERM and corporate governance are linked in a virtuous circle – strengthening oversight by senior management, clarifying risk management, and communicating actions and results of key objectives. As companies increase risk transparency, stakeholder confidence in their operational and financial capabilities will grow.
5. Expand and enhance catastrophe risk markets

Catastrophic risks are generally underinsured across Latin America, creating opportunities for insurance and reinsurance growth. Businesses and governments in the region understand they must ensure rapid infrastructure recovery after a catastrophe to avoid deteriorating economic conditions. These exposures require risk management tools and corporate governance that demand catastrophic risk management.

Most of Mexico, Central America, the Caribbean, and South America are exposed to substantial catastrophic loss exposures from hurricanes, tsunamis, earthquakes and flooding. Despite recent major earthquakes, catastrophe risks remain underinsured, e.g., the 2010 earthquake in Haiti caused US $14 billion in damage to rebuild the infrastructure, of which US$200 million was insured. Chile has a much higher insurance penetration than in other Latin American countries, yet the earthquake of 2010 caused nearly US$30 billion in losses, of which US$8.2 billion was insured. In more mature markets, insurance coverage is often 50% or more of the economic loss.

<table>
<thead>
<tr>
<th>Recent major Latin American earthquakes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Catastrophe</strong></td>
</tr>
<tr>
<td>15 August 2007 earthquake (8.0 Richter scale) in Peru</td>
</tr>
<tr>
<td>12 January 2010 earthquake (7.0 Richter scale) in Haiti</td>
</tr>
<tr>
<td>27 February 2010 earthquake (8.8 Richter scale) in Chile</td>
</tr>
</tbody>
</table>

Sources: Swiss Re, Guy Carpenter, EQECAT Inc. and AIR Worldwide, prepared by Ernst & Young
Significant modeling limitations remain for Latin American catastrophe risks, despite recent enhancements and adjustments. Concern over flooding risk, for instance, is increasing because of its ubiquity and the limited availability of modeled data.

Reforms over the past decade in many countries have increased the ability to access foreign capital, and investors are now requiring enhanced catastrophe risk management. Many governments are increasing their catastrophe assessment, prevention, mitigation and financing capabilities. The World Bank’s International Bank for Reconstruction and Development has also become active in encouraging capital market risk transfer mechanisms for developing and emerging countries.

Latin American governments’ recent catastrophe risk actions include:

- Colombia completed a vulnerability reduction program for its schools and hospitals in Bogota that noted a once-in-250 years earthquake could cause more than US$35 billion in losses.

- Mexico completed a capital markets transfer of catastrophe risks, known as MultiCat. This US$290 million bond instrument allows Mexico to diversify its catastrophe financing mix to reduce budgetary pressures in the event of a natural catastrophe. It also demonstrates more transparent assurances of adequate capital for disaster response.

The insurance industry recognizes the urgency in the region to fully develop catastrophe insurance markets and enhance catastrophe risk models. A stable commercial market will help deter government responses to gaps in market coverage.

Overall, Latin American insurance markets are seen as providing long-term compound-growth opportunities for insurers due to the emerging middle classes, historic, slow-to-mature insurance market development; and rising needs for catastrophe risk cover. These markets require intelligent investments in multiple technologies, knowledge-driven innovations in product and distribution, and advanced risk and capital management instruments.
Nordic
Focusing on customer growth opportunities
Market summary

Nordic insurers face a varied economic climate in 2013 as the four economies (Denmark, Finland, Norway and Sweden) respond to local conditions. While not all of the countries are part of the Eurozone, Nordic life and non-life insurers are confronting the development and implementation of European regulations that affect everything from capital and risk management to distribution and product design. In addition, increasing consumer transparency of products and pricing continues to pressure profit margins. This pricing pressure adds to the relative low, albeit steady, growth in these mature markets.

Against this backdrop, insurers must focus on managing economic and regulatory risks to capital and investments, identifying new opportunities to improve product and profit margins, and adapting systems and operations to address these critical challenges.

At the macroeconomic level, the Nordic countries will also face individual challenges this year. Denmark is headed for moderate growth, but a full-fledged recovery is a long way off. The Swedish economy is set for lower growth and increasing unemployment due to weakness in exports. Norway continues to experience the strongest growth, but the non-oil industry is under pressure and the housing market is beginning to give cause for concern. Finland is on the verge of recession, with growth not likely to pick up much in the near future. The potential for spillover from any Eurozone economic turmoil in 2013 could present further challenges for each country as well.

Additionally, all four countries are expected to continue the prolonged period of low interest rates. This will affect the financial resilience of Nordic life and non-life insurers as they struggle to maintain pricing margins and limit the impact on capital and reserves. In this environment, some insurers may seek to increase product prices, which may alter the behavior of consumers in terms of the quantity and type of insurance products they purchase. Compounding the difficulty in raising prices is the awareness of pricing differences as Nordic consumers increasingly turn to the internet to comparison shop for the best rates.

In this tumultuous environment, insurers operating in or evaluating the Nordic region will need to:

- Focus on customer growth opportunities in a low-growth region
- Protect market position
- Address customers’ needs as pricing transparency increases
- Respond to a sharpened regulatory focus on consumers
- Retool investment portfolio and balance investment and insurance risk mix
- Tackle the expense challenge
Focus on customer growth opportunities in a low-growth region

Nordic insurers are increasingly focusing on customers as they seek growth opportunities in the low-growth region. The life and non-life markets are dominated by a small number of local players. The top five, for example, received approximately 55% of 2011’s premiums for Denmark and Sweden, while Finland’s and Norway’s top five insurers received approximately 90%.

The non-life market is even more concentrated, with the top four players receiving between 67% and 90% of the premiums. Against this background, premium growth has been steady if unspectacular. The challenge task for insurers will be finding ways to improve premium growth and profitability.

While most insurers are focused on their home markets, some of the larger life and non-life players have become regional. At the same time, non-Nordic insurers have also moved into the region. For example, Insurance Sweden (Svensk Forsakring) pointed out in its latest statistical report that international presence has increased over the past 10 years, so that 38 foreign insurance companies were represented via branches or agencies among the 443 life, non-life and friendly societies in 2011. As in much of the region, similarities exist, but differences remain: Finland’s insurance market is relatively un-penetrated by non-Nordic insurers.

Identifying new growth opportunities carries different meanings based on company size. Looking to expand beyond the Nordic footprint may appeal to some of the larger regional insurers, especially as proposed European Union (EU) regulations standardize product and fee disclosures. Regional expansion, on the other hand, may offer opportunities for mid-sized players. The challenge in both cases this year is developing an efficient legal structure to enable that expansion.

Traditionally, expansion has meant establishing separate legal entities in each country. Proposed regulations, such as Solvency II, could add costs that locally focused players may not incur. At the same time, the ability to manage inter-country capital flows efficiently can be crucial if economic turmoil requires a head office to quickly support a local business unit. Thus, insurers looking to expand regionally and further into Europe this year will be considering how best to organize their operations for profitable growth.
### Insurance key facts for Nordic countries

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP: 2013 forecast</th>
<th>Inflation (consumer prices)</th>
<th>Life insurance penetration as % of GDP</th>
<th>Non-life penetration as % of GDP</th>
<th>2011 life premium in billion euros</th>
<th>2011 non-life premium in billion euros</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>0.70%</td>
<td>1.50%</td>
<td>6.4%</td>
<td>2.9%</td>
<td>15.1</td>
<td>7.6</td>
</tr>
<tr>
<td>Finland</td>
<td>0.50%</td>
<td>2.50%</td>
<td>7.7%</td>
<td>1.9%</td>
<td>14.5</td>
<td>3.4</td>
</tr>
<tr>
<td>Norway</td>
<td>3.10%</td>
<td>1.80%</td>
<td>2.6%</td>
<td>1.7%</td>
<td>9.4</td>
<td>5.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>1.20%</td>
<td>0.40%</td>
<td>6.0%</td>
<td>1.9%</td>
<td>22.3</td>
<td>6.7</td>
</tr>
<tr>
<td>Euroland</td>
<td>0.30%</td>
<td>1.80%</td>
<td>4.1%</td>
<td>3.0%</td>
<td>633.6</td>
<td>332.9</td>
</tr>
</tbody>
</table>


### Protect market position

The high level of market concentration in the region by entrenched Nordic giants, combined with the relatively small size of the market, has been a deterrent for non-Nordic insurers seeking a foothold in these countries. Furthermore, there are additional barriers to entry, such as the Finnish practice of local insurers subsidizing poor general insurance results with their participation in mandatory covers typically not accessible to foreign insurers. The combination of the unprofitable non-life line with the more profitable mandatory personal accident and employee benefit coverages (the latter dominated by local Finnish players) contributes to the reputation of the Finnish market as being “protected.”

The flip side to the insularity of the Nordic market and its domination by a handful of regional players is the opportunity to carve out a niche by introducing new, specialty products not currently offered by the market leaders. One example is a multinational insurer that began its Nordic operations in 2007, when the global financial crisis was starting to pinch the region. In addition to its transport and energy expertise, the company has a green energy practice, which is well suited to a region recognized for its environmentally conscious and ambitious green energy targets. A more attractive option for insurers unwilling to assume the considerable risks and expenses of establishing a greenfield operation in the region is to acquire an existing insurer.

Although relatively small, the region is not monolithic. Insurers contemplating entry must be aware of the important differences in the economies, insurance risk and business cultures of the four Nordic countries, and the varying challenges they pose. These variations have an impact on business opportunity and risk appetite, as well as on staffing considerations, because locals are typically more adept at operating within business styles generated by the respective national cultures. The most catastrophe-prone country is Denmark, with southern Jutland and Lolland exposed to periodic flood risk. Denmark's economy is heavily service-oriented and is the hub of regional reinsurance. Norway's economy, by contrast, is heavily oil-driven. Finally, both Finland and Sweden have mixes of export-led natural resources, as well as knowledge-intensive high-technology and manufacturing industries.

Insurers contemplating entry into these markets must be aware of the nature of the prevailing risks, opportunities and business cultures they must master. Established insurers wishing to protect their turf against new entrants should preemptively identify the developing opportunities and exposures to plan their own business development strategies.

Global insurance outlook
Address customers' needs as pricing transparency increases

Expanding into new regions is one way to achieve growth. However, within their existing markets, Nordic insurers will increasingly seek to better understand their customers' needs and develop products that meet those needs. A key driver will be the continued increase in transparency around product pricing, costs and consumer benefits. That said, Nordic consumers still value service and trust slightly more than price. Looking ahead, however, as transparency increases, insurers face the threat of lower pricing margins and the possible commoditization of products.

In the year ahead, Nordic insurers will continue integrating online and offline communication channels. The speed of information-sharing among insurers, distributors and consumers places a strategic advantage on reducing or eliminating dataflow roadblocks and checkpoints. For example, a property and casualty insurance company in the Nordic region reported that the millions of insurance policies that it previously kept on paper in enormous archives are now stored digitally, enabling it to process new sales and claims more efficient. In fact, it performs fully automated processing for certain claims, providing customers with lightning-fast answers regarding compensation via email or smart phone.

Improving online processing and communications is an ideal strategic fit for the Nordic market as the region's consumers are very well-connected to the internet. For example, according to SE's 2012 report on Swedish internet usage, 86% of the Swedish population over the age of 18 uses the internet. Among the various age demographics between 12 and 35, 90% or more use the internet daily. In Norway, 86% of the population is active online, with 62% of the 60+ age group (traditionally the most digitally excluded) claiming regular internet usage, while 96% of Norwegians own mobile phones.

This high degree of connectivity opens the door for consumers to research and compare products and prices. It also creates opportunities for comparison sites. In 2013 and beyond, the demand for and use of comparison sites should continue to rise as the Nordic market is one of the greatest users of the internet in Europe, and consumer-buying patterns are adapted to that channel.

The success of the price comparison model in the Nordics is not, however, a foregone conclusion as insurance-purchasing decisions in these countries have been driven by service. Many Swedish consumers use the sites for research rather than purchasing. The tool Compricer, for example, has one million users per year. But only about 5% of insurance in Sweden is bought through aggregators. While the market is very price sensitive, brand trust and existing relationships with insurers play an important role in the policy selection process.
Respond to a sharpened regulatory focus on consumers

Regulations from Brussels are impacting Nordic insurers by sharpening the focus on consumer fairness and protection. From the adoption of gender-neutral pricing to greater disclosure of distribution fees and product costs, Nordic insurers will need to respond to the new regulations over the course of the year.

Among other measures, they will be adjusting to the European ban on gender-based pricing, which will increase the price of insurance across life and non-life products. For motor insurers in the region, a growing value-added service is increasing the use of telematics to tailor prices to individual consumer driving patterns. As with the broader use of the internet to reach consumers, telematics is a natural fit in the Nordic region. For decades, Sweden has been at the forefront of automotive and telecommunications technologies. The unique combination of expertise in these two areas has established Sweden as one of the world's leading centers for automotive telematics. In a relatively short time, an automotive telematics cluster – known as Telematics Valley – has grown up around Göteborg in western Sweden, as well as at the Royal Institute of Technology in Stockholm. It is a hotbed of innovation and the home to telematics' developers and producers of software, hardware and services, as well as to telecommunications vendors and operators.

Insurers considering the use of telematics need to understand how its adoption may be affected by sales via internet aggregators. Additionally, carriers considering the implementation of a telematics solution must evaluate the demands it would place on IT functions, especially in the areas of data security and processing. Given the regional closeness of telematics expertise, Nordic insurers may continue finding ways to develop an advantage through this technology.

Companies also need to adjust products and distribution to meet proposed regulations, such as the Markets in Financial Instruments Directive (MiFID II), Packaged Retail Investment Products (PRIPs) and the Insurance Mediation Directive (IMD), that heighten consumer awareness of the fees they pay for products and services received. While Norway is not part of the EU, it is a member of the wider European Economic Area and the European Asset Management and Fund Association and is participating in the development and implementation of these regulations. PRIPs, for example, will require Nordic insurers to provide a “key information document” (KID) to consumers prior to their purchase of a policy. As the term “investment product” is not limited to products designed for retail investors, the test of whether a PRIPS KID is required in relation to a particular investment product will be determined at the distribution level. The rationale for this is that PRIPs require the seller of an investment product to a retail investor to provide the KID to that investor prior to the sale. It is not clear from PRIPs whether, or to what extent, a manufacturer could be liable for breach by the seller of such an obligation.

Insurers may find these directives call for the investment of a significant amount of time and resources to identify and produce the relevant disclosures and adjust multiple distribution models.
Nordic insurers will need to make difficult choices with long-term implications in 2013 as they confront the challenge of de-risking by trimming down the equity component of their investment portfolios.

Retool investment portfolio and balance investment and insurance risk mix

Nordic insurers will need to make difficult choices with long-term implications in 2013 as they confront the challenge of de-risking by trimming down the equity component of their investment portfolios. The exceptionally high equity composition of their investment portfolios is coming under pressure from the eventual implementation of Solvency II, which will result in higher capital charges for equity investments. Equities account for more than 25% of the investment portfolios of Nordic insurers and can rise as high as 40%, significantly higher than their non-Nordic European counterparts with approximately 8% in equities. The prevailing, historically low-interest-rate environment makes the choices more difficult because they not only depress book yields but also eliminate margins from guaranteed return products.

The comparatively high equity component of these investment portfolios is responsible for boosting the capital requirement in the Solvency II QIS 5 field test because of the higher market risk associated with equities. Rebalancing investment portfolios to trim the overweight equity position will likely result in a shift to bond holdings, but that brings its own challenges. At the end of 2012, 10-year Nordic government bonds carried yields ranging from a low of 1.5% for Denmark to a high of 2.0% for Norway. Shorter-duration instruments, naturally, had even less attractive yields.

The low-interest-rate environment for Nordic government bonds may induce insurance company management to consider other financial instruments in their search for yield. The low rates have prompted Denmark and Sweden to propose floors on the discount rate to protect savings and pension products. Lower investment returns are driving insurers to make a fundamental change to seek greater profits from insurance rather than investments. Insurers will likely resist the temptation to reach for higher returns by assuming significantly more investment risk from untested alternatives since financial crisis-induced insurance company travails were brought about by exposure to high-risk investments.

Regardless of the investment strategy pursued this year, the inevitability of anemic yields will push carriers operating in the region to focus more on insurance risk. Pressures to preemptively shed capital-intensive legacy lines have already induced insurers to release trapped capital. Several acquisitions of runoff portfolios in the region were transactions announced in 2012.

Another objective sought by numerous European insurers pursuing runoff solutions in 2012 was simplification, or greater transparency. Many regulators and shareholders view insurers as overly complex black boxes. The result is that regulators tend to lump insurers with banks, and investors are not attracted to the shares of companies whose operations they cannot fathom. Freeing capital and reducing complexity will likely continue to be desirable in 2013, and we expect to see more instances of runoff, spinoff or shedding non-core operations.

The proper response to the investment challenge for Nordic insurers in search of yield this year will be to “get back to basics” and trade off investment risk for insurance risk, with a redoubled focus on risk selection and pricing.
Tackle the expense challenge

Expense reduction is a top-of-mind issue for Nordic insurers. This means that any company operating in the region will have to keep pace with expense management trends to stay competitive and preserve margins. The limited potential for organic growth from lagging economic expansion and a declining population and the pressures on investment income from the interest-rate environment have turned up the heat on the cost component of operations. Some Nordic insurers have among the lowest expense ratios of any European insurers. This raises the bar for existing insurers or new entrants to operate at exceptionally high levels of efficiency. One Nordic insurer has laid out a goal to achieve a 10% expense ratio by 2020, accompanied by strategies for attaining it.

Three broad areas currently being explored to bring down expenses include internal structural retooling, process modernization and changes at the customer end. Structural retooling involves managing headcount with limited replacement of retiring and aging staff, reducing the number of local branches and tweaking the regional structure to a hub-and-spoke formation wherever possible. In 2012, such savings were achieved at one Nordic insurer by reducing 200 positions through merging offices with overlapping functions, and at another by reducing local offices and eliminating regional offices.

Process modernization opportunities for Nordic insurers include outsourcing non-core business activities and making system improvements to simplify and integrate the full range of business processes from the front end to the back end. Carriers are already at the leading edge of exploiting new technologies, including social media for customer interactions, but opportunities to reduce expenses still abound. Other initiatives currently being pursued in the Nordic region are at the customer end and include increasing the amount of self-service performed by customers. One insurer is moving to a model of 100% internet-based customer interactions in order to reduce costly local telephone or call center expenses. The shift to more self-service is consistent with the trend in the region for individuals to play a stronger role in managing their accumulated savings.

Insurers have already taken significant strides to reduce distribution expense by abolishing commissions in most countries, with brokers paid on a fee basis where they are involved. Norway still allows broker commissions but may ban them in 2013. In Norway and the other Nordic countries, however, brokers are typically not involved in small to medium-sized business accounts or personal lines business.

Insurers in the region have no choice but to scrutinize their expense line and identify opportunities for savings in 2013, under pressure from peer companies and investment-led shrinking margins in a mature, competitive market.
US life-annuity
Rethinking strategy for sustainable growth
Market summary

The US life insurance industry is confronting significant demographic, macroeconomic and regulatory challenges to business models and operations. In 2013, successful players are repositioning and reinventing their products, strategies and services, positioning their companies for growth and profitability in the competitive, lower-margin market.

Insurers are competing in a market where average household expenditures on life insurance have declined 50% over the past decade, a decrease most noticeable among younger consumers. Product preferences for all consumers are also altering, given the prolonged low-interest-rate environment and equity market upheaval.

In response, US life insurers are transforming their products and businesses. Many are introducing novel products and enhancements that are attractive to consumers and profitable for insurers in the low-interest-rate environment. Carriers are leveraging technology to improve business models and product offerings, thus enhancing their value propositions to customers, while restructuring operations and distribution to communicate and transact with customers on their terms.

These positive developments are expected to continue in 2013, despite the persistent economic difficulties. Real Gross Domestic Product (GDP) is expected to grow only modestly between the fourth quarter of 2012 and the fourth quarter of 2013, although the unemployment rate could begin to improve during the year. Interest rates are likely to remain low, and equity markets are expected to be volatile. Insurers’ financial positions will be impacted by management and expense fee instability, Deferred Acquisition Cost (DAC) write-downs, hedging losses and basis risk and reserves and capital adequacy.

The continuing volatility is causing reluctance among consumers with regard to purchasing variable products, and the low crediting rates on fixed products are not perceived as a particularly attractive alternative.

Regulatory forces also challenge the industry. At the federal level, life insurers with banking operations, or those designated a Systemically Important Financial Institution (SIFI), confront possible increased regulation by the Federal Reserve to improve risk management. Life insurers also must prepare for possible actions taken by the new Consumer Financial Protection Bureau (CFPB), which reviews assorted financial services transactions like insurance sales.
Other pressures include emerging US and international accounting standards that may adversely affect business operations and business models. At the state level, life insurers continue to adapt to current and prospective National Association of Insurance Commissioners (NAIC) regulations, such as the Risk Management and Own Risk and Solvency Assessment Model Act, commonly called ORSA.

Within this economic environment, many companies are rethinking the businesses they are in and developing new ways to sustain a profitable, competitive advantage. Outsourcing and shared services, for instance, may reduce costs and improve efficiency, in addition to increased use of data analytics, mobility and digitization – the buzzwords of the moment. Indeed, operations and technology are increasingly the source of competitive advantage.

In 2013, insurers should continue to address the changing regulatory environment by evaluating their product lines and markets. Improving capital and risk management still remains a priority, as does a continuing engagement with legislators to shape key tax policies.

To respond to these market forces during the coming year, senior management needs to:

- Rethink business strategy for sustainable competitive advantage
- Respond to consumer needs and changing distribution to grow
- Transform products to adapt to economic challenges by:
  - Preparing for a scenario of long-term, low interest rates
  - De-risking and redesigning products
- Harness big data for sustainable advantage
- Position the business for tax, regulatory and accounting change by:
  - Staying attentive to tax changes in this time of governmental need for revenue
  - Increasing focus on risk management and consumer protection to prepare for regulatory change
  - Organizing and planning for accounting change

Within this economic environment, many companies are rethinking the businesses they are in and developing new ways to sustain a profitable, competitive advantage.
Rethink business strategy for sustainable competitive advantage

The competitive landscape of the US life insurance industry is changing. New players are entering the industry, established players are exiting lines or markets, the largest carriers are continuing to gain scale and distributors are consolidating, increasing competition for shelf space. Regulators of the industry, meanwhile, are evaluating suitability standards that could further alter distributor and insurer sales practices.

Insurers are responding by rethinking business strategies to obtain a sustainable advantage. Larger insurers are gaining scale in assets and market share to attain an advantage over smaller competitors. New market entrants acquiring existing insurers are developing new products to attract the interest and assets of the growing number of pre- and post-retirees. Both insurers and distributors are adapting to the technological sophistication of increasingly connected consumers.

The creative destruction caused by firms exiting the industry creates opportunities. For insurers exiting a line of business or market, their books of business, products and distribution networks are available for purchase. This enables new entrants to quickly build operational scale and capacity, as well as market reach.

To remain competitive, the challenge is not just to gain size, i.e., rank among the top three players or exit the business. Rather, to obtain a sustainable advantage, carriers are evaluating books of business in terms of their ability to generate profits and diversify risks, regardless of the macroeconomic environment. For some carriers, this may entail a reduction in sales as consumers shift toward the remaining players. The goal for many companies is a balanced product portfolio in which no single line dominates the business.

Consolidation among distributors remains a challenge, as does an aging sales force. With fewer agents, registered representatives and firms, competition for shelf space is heating up. Some insurers are reconsidering the merits of captive or career sales forces, while others are actively rebuilding these forces or developing channel-specific products that more closely tie independent distributors to them.

In 2013, increased regulatory attention with regard to compliance and compensation may be in store for insurers and distributors. Differences in suitability standards among agents, registered representatives and registered investment advisors remain unsettled and would impact established sales and compensation processes. Distributors and insurers should remain engaged in the standards discussions, while developing contingency plans.
Response to consumer needs and changing distribution to grow

Strained by the country’s current financial situation, the average household expenditure on insurance has declined substantially over the past decade. Although a 2012 industry study indicates that life insurance premium growth kept pace with inflation over the past 45 years, the real growth in the number of policies over this period is zero. Insurers need to re-examine the value proposition to consumers, addressing the converging forces of demographics, consumer needs and product distribution.

Demographics are vital to the life business. For several years, insurers have focused on the value proposition to baby boomers, developing complex retirement savings and insurance products. Life insurance sales to younger consumers languished as the industry’s value proposition clouded, however. Greater attention must be accorded the risk transfer and savings needs of young people, while continuing to build the case for retirees and pre-retirees. In brief, products must address each customer’s specific and multiple needs — the case with combination life insurance and long-term care insurance products for older consumers, which have benefited at the expense of traditional long-term care insurance products.

Insurers also should consider new ways to market existing portfolios of simpler products, like term and whole life insurance to younger consumers, increasing the emphasis on digital marketing and mobile distribution strategies. The younger demographic prefers to conduct online research and is more likely to purchase online. This requires an effective internet and social media presence, and calls for investments in search word optimization; mobile platforms; and faster, easier and secure transactional functionality.

These strategies are challenged by cost, security concerns and regulatory requirements on the use of the internet and social media for marketing and distribution purposes. Providing broad customer data, often stored on multiple back-office systems, to agents and other distribution channels also is challenging, but the opportunities presented make these investments imperative for growth purposes.
Transform products to adapt to economic challenges

The macroeconomic environment has been challenging for life insurers, and promises to remain so for a protracted period of time. Product innovation can help insurers weather the climate by strengthening the customer value proposition.

Prepare for a scenario of long-term, low interest rates

Now that the Federal Reserve has announced its third program of quantitative easing, the likelihood of higher interest rates has dimmed. While interest rates have decreased since the early 1980s, the prevailing rates were above the required interest rate to maintain policyholder reserves and profitability; consequently, the margin squeeze came primarily from competition. The squeeze now is coming from the interest rate environment itself.

In the face of such unrelenting interest rate pressure, business strategy needs to change. Life insurers no longer can manage the problem purely as a short-term crisis—it is now a likely long-term operating challenge. This is complicated by the limited ability insurers have to reduce interest rate risks for savings and investment-oriented products like deferred annuities. While the product mix and features will continue to shift, lower projected profitability is to be expected.

Many life insurers have responded by altering product design—reducing the minimum guaranteed crediting rates and/or de-risking certain products, while making products more attractive and thereby profitable. A renewed focus on asset management and wealth management, and less focus on costly and risky guarantees, also seems in store.

To obtain greater yield, insurers may need to increase risk taking in their asset portfolios, understanding they will have to be adequately compensated in yield for taking on the additional risk. Whether through product reinvention, tax strategies, captives or asset-liability management to achieve improved profitability, life insurers will continue to leverage innovative measures to optimize results, until interest rate levels inevitably rise.

De-risk and redesign products

Equity and credit market volatility is increasing awareness of the risks that underlie the optionality provided in insurance products. Prior to the financial crisis, these risks were thought to be well understood and adequately priced. In hindsight, the industry erred.

Income from products that depend on asset-based management fees has been volatile, decreasing earnings. Hedging programs are less effective and more expensive. As a result, the life industry must decrease risk exposure and enhance product appeal—a challenging scenario.

Insurance companies are paid to bear risks that customers are unable to bear. Therefore, decreasing the amount of absorbed risk seems at odds with enhanced product value, especially when customers are less capable of taking on risk in the current economy.

Consequently, product-oriented techniques that reduce volatility for both customers and the insurance company will be better received.

Actions taken by life insurers include fee increases for variable products, reflecting the cost of hedging in the volatile environment; investment restrictions limiting the amount
Low interest rates, reduced demand for insurance products and compressed margins make success in 2013 highly dependent on expense efficiency, improved underwriting and sustainable cost reductions.

of assumed risk by customers; and automatic rebalancing regimes protecting customers from significant asset value movements, while stabilizing the insurer’s fee income.

Targeting product characteristics valued by customers (and removing less-valued features) reduces insured risk and leads to simpler products with more clear, apparent and targeted value propositions. Whole life insurance and term life insurance, for instance, are popular because of their easy-to-understand, straightforward value proposition. Companies must continue to design easy to understand and flexible products suitable in a broad range of environments.

Harness big data for sustainable advantage

Low interest rates, reduced demand for insurance products and compressed margins make success in 2013 highly dependent on expense efficiency, improved underwriting and sustainable cost reductions.

Business and regulatory demands are driving investments in IT infrastructure, where the return on investment is compelling, particularly for insurers with legacy systems. The industry must continue to invest in highly innovative technologies to reduce costs and lift profits, re-evaluating existing business models and product offerings to optimize capital resources. The chief information officer can be a strategic partner helping prioritize resource allocation for maximum competitive impact.

Outsourcing and the shedding of non-core businesses will continue to be cost-effective strategies. But, to attain long-range gains, more fundamental process changes are required, including investments in digitization, predictive modeling and consumer analytics. Modeling tools that enhance customer segmentation data provide more accurate underwriting to enlarge margins.

Greater use of predictive modeling also speeds the underwriting process, resulting in faster policy issuance and higher sales (by lowering the “not taken” rate). Predictive modeling further decreases sales and marketing expenses, leveraging customer preferences to target those individuals most likely to purchase products.

Digitization offers consumers the freedom to purchase products, access information and communicate with companies and distributors on their terms, at their convenience via email, voice, social media and web and mobile devices.

Sophisticated modeling techniques require investments in talent to deliver these capabilities at a time when demand for this talent is high and expensive to hold on to. Management also must champion the use of these tools throughout the enterprise to deliver on the promise.
Position the business for tax, regulatory and accounting change

Several changes to the tax, regulatory and accounting standards environment are in store in 2013, affecting the attractiveness of insurance products and posing operational and compliance challenges.

Stay attentive to tax changes in this time of governmental need for revenue

The 2012 elections returned a vote for a similarly constituted federal government: Republican control of the House of Representatives and Democratic control of the Senate and White House. As a “fiscal cliff” loomed for Congress at year-end, hopes were high for a compromise on planned tax and spending increases and decreases.

Higher individual taxes appeared likely, especially for higher-income households. Capital gains taxes and estate taxes also seem poised to increase, were a compromise not forthcoming. This may spur increased sales of life insurance and annuities to high-net-worth individuals, especially if tax reduction loopholes are closed to capped.

The possible positive impact on the life insurance industry is offset by the government’s possible demand for increased revenues from the industry. This also may occur at the state level and extends beyond taxes, such as the recent interest in escheatment of unclaimed death benefits, even though the amounts involved would do little to replenish state budgets. Premium taxes and corporate taxes also could increase.

Of greater concern are issues around the tax status of death benefits and the accumulation of cash values within life insurance policies and annuities, an issue the industry has defended successfully in the past. As insurers depend more on business generated by high-net-worth customers, the traditional arguments of the importance of insurance to protect the middle market may weaken. Congress may try to split the difference by means-testing the taxability of these products, reducing the tax positioning that helps propel sales in the high-net-worth sector. Companies diversifying their customer mix need to keep an eye on both the potential advantages and disadvantages of increased individual taxes.
Increase focus on risk management and consumer protection to prepare for regulatory change

Several regulatory projects are reaching the finish line, such as Solvency II in the European Union, despite ongoing financial turmoil. The NAIC is closer to introducing its Solvency Modernization Initiative, has passed the ORSA model law and related regulations, introduced a new life insurance valuation manual and has begun work on updating the Risk-Based Capital formula and factors. The Federal Stability Oversight Council recently issued its final rules on the designation of SIFIs, and is reviewing possible candidates. A common theme in these projects is the focus on risk governance and risk management.

Individual US states that, in the past, have focused primarily on banks are developing similar requirements. Key in these proposals is high-level responsibility within organizations for establishing risk management policies and risk appetite. Management and board directors are expected to have a technical understanding of the nature of enterprise risk, possibly requiring more education. Rating agencies also seek proof of responsible risk governance and more transparent risk reporting.

Market conduct is another regulatory focus. The NAIC, for instance, adopted updated annuity suitability and disclosure model regulations. As more baby boomers retire and seek out retirement solutions, producers will pressure providers to sell these products. Establishing proper communications with producers and customers, as well as the processes required for compliance review, is increasingly important.
The creation of the Consumer Financial Protection Bureau (CFPB) further enhances market conduct scrutiny. CFPB is tasked with examining the transparency and fairness of diverse financial products and services, and so far has focused on banking and consumer loans, but will soon be studying insurance products. The federal agency may be granted enforcement powers, including fines and disciplinary actions. Given the relative obscurity of many life insurance investment-related products, the pressure for product transparency and simplified pricing is intensifying. Simplifying the product mix can help insurers streamline operations and reduce regulatory compliance burdens.

**Organize and plan for accounting change**

Both the Financial Accounting Standards Board and the International Accounting Standards Board are continuing to revisit insurance accounting videlicet, US Generally Accepted Accounting Principles and International Financial Reporting Standards. Current exposure drafts indicate that approaches to insurance accounting will change under both standards. Future exposure drafts from both bodies may arrive in the second quarter of 2013, with a likely effective date of January 1, 2016, and delivery of the first annual financial statements at year-end 2016.

The new standards pose enterprise-wide consequences. Life insurers must ensure that systems, people and data are prepared and capable of implementing the new requirements. Profitability will be affected by the timing of recognition of cash flows. In light of these changes, some products may become more or less available.

Until final standards and effective dates are established, insurers should prepare by reviewing their policies, processes and controls, and the reporting of financial results. Other prudent measures include analyzing changed profitability in a post-standards environment, conducting pilot studies and crafting an implementation road map.

The comment period on the exposure drafts of the new accounting standards is expected to draw to a close at midyear 2013, meaning the last opportunity to influence the process is in 2013. Ahead of implementation, insurers should educate staff on the subject, and participate in the current debate to influence developments. A final thought is to evaluate possible alternatives to the standards through a pilot test.

Finally, these various regulatory pressures will have a significant impact on the life insurance industry’s existing technologies, compelling many insurers to consider transforming IT capabilities to assist their compliance objectives.
US property/casualty

Extracting operating efficiencies in a challenging growth environment
**Market summary**

In 2013, the uncertain economic environment and limited investment income opportunities will challenge US property/casualty insurers to improve underwriting results, while seeking growth. The continuing prospects for weak investment returns and low interest rates over an extended period compel carriers to improve underwriting margins, requiring difficult decisions concerning pricing and operating approaches. Organic growth continues to be a challenge, given the economic situation and the competitive landscape. Despite these impediments, growth opportunities are available through acquisitions, including international expansion plays, as well as product solutions targeting new insurable risks and coverage expansions.

As the US property/casualty sector addresses and reacts to these growth and profitability challenges in 2013, individual insurers confront greater competition, driven by an abundance of capital, uncertainty around the timing and scope of regulatory changes and the continuing volatility caused by weather-related losses, highlighted most recently by so-called Superstorm Sandy. To outperform competitors by maximizing customer profitability and persistency, continuing investments in infrastructure and technology are required. Many companies are in the early stages of investing in internal data and systems capabilities, yielding information advantages and improved analytical and decision-making capabilities, thereby providing competitive opportunities. Carriers that have invested in outsourcing, for example, are making these decisions not solely for cost-effective reasons, but also increasingly for customer impact and retention purposes.

US property/casualty insurers must approach these challenges and opportunities holistically, understanding their interplay and effect on underwriting, operations and investment considerations. Growth and profitability strategies need to be developed on an enterprise-wide basis and balanced against the risks they may produce. Ernst & Young believes the following issues will drive management’s priorities over the coming months:

- Invest in the business for the long term, as a response to the difficult investment environment
- Prepare for changes to the regulatory environment
- Exploit opportunities and address challenges with “Big Data”
- Identify growth opportunities and begin to execute them
Invest in the business for the long term, as a response to the difficult investment environment

As volatile markets continue to pressure investment returns, US property/casualty insurers must rely on underwriting results to support profitability. Given the lack of attractive options to achieve investment yields, the best opportunity for many carriers to increase profitability may be investments in infrastructure, systems and intellectual capital, which can enhance margins while addressing risks that are not directly related to premium production.

Many insurers remain encumbered by legacy systems and associated business processes; consequently, the prospective return on investments in updated infrastructure becomes quite compelling. Claims and billing services are a focal point, as consumers increasingly look toward technology-enabled transformation to improve the insurance service experience. Consumers increasingly want real-time insurance solutions that can be delivered through mobile communication, among other channels. Such expectations are difficult to achieve without substantial technology upgrades.

At the same time, the regulatory requirements for US property/casualty insurers to protect customer personal information have increased. To provide real-time insurance interactions with consumers via cloud-based technology, social media and mobile communications, carriers must also invest in effective security solutions.

Enhanced operational efficiencies are another necessity, extending beyond just managing internal costs. New market entrants have a competitive advantage in this regard, as they are not burdened by legacy infrastructures. Customer service remains a differentiating characteristic among insurers, and adequate resources are necessary to meet customer expectations and compete effectively.

Migrating toward greater data and systems efficiencies will give insurers access to integrated information that permits a more analytical-based approach to making decisions and conducting business. Historical data can be a treasure trove for decision-making purposes, but it must be unleashed from legacy systems and aggregated across the enterprise, business units and processes. Improving operating efficiencies does not guarantee better underwriting results, as outside forces will continue to affect underwriting performance. Nevertheless, technology can enhance underwriting productivity and improve the ability to meet the needs of customers. Additionally, technological improvements in the claims handling process, via the adoption of predictive modeling and so-called leakage analyses, can contribute to better oversight of the claims process — for example, managing claim payouts, which ultimately guide improved profitability. Early detection of potentially adverse claim developments through enhanced analytics capabilities can thus sharpen an insurer’s competitive edge, while yielding cost savings in the challenging economic environment.
Historically, outsourcing various operations in the US property/casualty sector was driven by strategic expense management objectives and the desire to streamline business functions, i.e., shedding non-core operations to service providers to achieve both lower costs and operating efficiencies. A debate has now emerged as to whether or not these cost improvements have come at the expense of customer service and data integration. New quality measures will define the next generation of outsourcing decisions. Insurers will need to assess the benefit of lower expenses delivered through outsourcing against the impact on business strategy and customer service expectations.

**Prepare for changes to the regulatory environment**

In 2013, US property/casualty insurers will confront rising activity among regulatory authorities and quasi-regulatory agencies focused on strengthening insurance solvency protection systems. Among the regulatory initiatives facing insurers are Solvency II, a fundamental restructuring of the capital adequacy regulations for the European insurance industry; the National Association of Insurance Commissioners’ (NAIC) Solvency Modernization Initiative (SMI), which calls for a critical review of the US insurance capital adequacy system; and the NAIC’s Own Risk Solvency Assessment (ORSA).

State insurance departments and rating agencies are also influencing the direction of solvency regulation in the US. While these varied initiatives place differing degrees of emphasis on capital requirements, reporting standards and risk measures, a common theme is their intensified focus on clearly articulating an insurer’s risk profile. To prepare and address the regulatory pressures to enhance risk management, insurers must increase their data management, reporting and analytical resources, and their organizations’ ability to integrate risk data across disciplines.

To address the varied risk-sensitive measures and reporting requirements, insurers must improve data quality and data governance. Data management needs will broaden and deepen in the future, given more stringent modeling requirements. Carriers will need to obtain a comprehensive view of enterprise risks, pulling from asset and liability data sets. This, in turn, will spark demands for greater information availability and granularity.

Management and board members are now personally obligated by both Sarbanes-Oxley and the Securities and Exchange Commission, respectively, to have a technical understanding of enterprise risk. Regulators and credit rating agencies also are demanding greater accountability by senior managers and the board. Evolving regulatory demands further drive the need to integrate data across functions. Insurers also need to present a more detailed understanding of a broader set of risk drivers, while developing a clearer understanding of the ways in which different risks across the organization interact to shape the overall risk profile. These risk management pressures may require additional investments in education across the organization, and in other strategies to achieve an integrated view of the organization’s risk profile.
Larger insurers are more able to possess sufficient resources and capabilities to meet these stepped-up requirements. Small and mid-sized insurers, on the other hand, may be more adversely affected, given their more meager resources to devote to these tasks. Indeed, many companies are rightly concerned that the costs of compliance will exceed the benefits.

The complexity of regulatory requirements can quickly escalate. The current regulatory reassessments are happening as part of a broader trend in financial services, in which more stringent capital rules are being imposed on banks, in particular. Insurers are now caught up in this broader focus on enhanced capital levels, which may prove troubling, since property/casualty companies operate under a different business model and face different risks compared to banks. The “run-on-the-bank” concern drives much of the solvency attention in banking regulation, but is not really a risk for US property/casualty insurers. With much of the solvency framework still in progress, insurers’ flexibility, in addition to a solid finance and actuarial foundation, are vital. The key is to stay on top of emerging regulatory trends, while preparing the organization for escalating data, and reporting and governance demands, regardless of the regulations’ final form.
Exploit opportunities and address challenges with Big Data

US property/casualty insurers have access to a rapidly expanding volume of data from transactions, claim histories, social media connections, internet searches and GPS-type devices. A competitive advantage exists for those insurers that are capable of capturing and analyzing this wide-ranging data, integrating it with existing data and thereby developing new views of the business that guide innovative approaches. Insurers have the opportunity to integrate and leverage these data capabilities across the entire value chain, from distribution and underwriting to customer service and claims. However, along with this opportunity are challenges.

Data management and analytics have been a fundamental element of insurance operations for decades, but the explosive growth in the abundance and types of data, and the speed with which this is delivered demand a new company operating structure. This era of “Big Data” involves more than traditional analytical tools and capabilities, referring extremely large and complex data sets beyond the ability of traditional database and software tools to house, organize and analyze.

Vehicle telematics, for example, provide a hint at what this new era offers. Traditional application-based underwriting information provided a snapshot of the risk under consideration. Telematics, on the other hand, takes a step beyond regularly updatable risk assessment variables, providing a real-time dataset with real-time delivery, representing an order of magnitude increase in the volume and speed of data delivered. This information extends beyond aggregated market data to include specific information about individual behavior patterns, thus expanding insurer-pricing possibilities. The technology also offers the claims function the opportunity to record data from accidents as they occur, to begin the claims process the instant the event takes place. This, in turn, offers the promise of expedited claim payments, reducing policyholder uncertainty and improving customer satisfaction. While the automobile lines of business are the initial beneficiaries of Big Data, opportunities are emerging in homeowners insurance (among others), with video monitors, security systems and gaming systems all collecting and transmitting usable data.

The new insight provided into customer preferences and behaviors can substantially assist insurers’ cross-selling and retention initiatives, while offering new approaches to address claims leakage. Nevertheless, insurers seeking to capitalize on these opportunities confront challenges before they realize gains. Most companies, for instance, lack the sophistication at this juncture to achieve meaningful benefit from the effort. The traditional problem of data integration from incompatible legacy systems was a limitation for early data management initiatives and will continue to plague analytical advances until it is solved. Step one thus involves getting existing data management capabilities in order to extract meaningful information from a Big Data endeavor. This process begins with integrating data from multiple sources typically housed in various functional areas, i.e., data becomes much more useful when shared.
Another challenge is the shortage of data management talent to pursue these opportunities. Big Data presents new operating possibilities, but it will require new skill sets, with the role of data scientists assuming greater visibility within the organization. Insurers will need to invest in employees who have the skill sets necessary to collect, analyze, disseminate and manage massive volumes of data. Tying this all together will likely require a new set of leadership capabilities, such as appointing a chief data officer, a role expected to assume greater prominence in the future.

A final concern is privacy. Much of the information gathered involves people, creating issues over privacy and data ownership. Individuals are willingly sharing much more personal data than ever before, in exchange for a benefit, but this creates substantial risks for insurers entrusted with guaranteeing the security of this personal information. Data security, with enhanced governance systems and threat and vulnerability assessment capabilities, is becoming a more critical element of the business.

The explosion of data opens an array of new areas to be mined by insurers for competitive advantage. The ability to innovate via Big Data will be a key differentiator in 2013, but success must build on the successful execution of these foundation elements.

**Identify growth opportunities and begin to execute them**

In addition to improving profitability and persistency, US property/casualty insurers are challenged in 2013 by a pronounced need for growth. As the US struggles to emerge from the recession, low interest rates continue to pressure underwriting results. Insurers need to discover and seize new ways to grow premiums and exposures, but in the absence of a clear hard market, they must seek alternatives to organic growth.

Acquisitions are one way for insurers to diversify and expand by location, product or distribution source. This runs the gamut from acquiring or merging a company to individuals or teams of employees to fulfill product capabilities. Expanding internationally can reduce domestic insurers’ dependence on the US economy – hence, the move by several US insurers to directly acquire or engage in joint ventures with foreign companies, especially in the Lloyd’s market. Premium growth opportunities in the US also may be derived from insuring new or emerging exposures in such growing fields as cyber liability, nanotechnology and energy. Finally, cross-selling products offer insurers the opportunity for both increased profitability and persistency.

While the US market is a vast one, many insurers see drawbacks to being concentrated entirely in a single country. Domestic insurers are exposed to US economic and market conditions that limit growth prospects. As a result, premiums enlarge and shrink based on
both economic and underwriting cycles. Large US insurers are also subject to concentrated
distribution sources, as the largest brokers account for the majority of premiums placed.
Insurers can benefit by turning to emerging markets in the Asia-Pacific and Latin America
regions for more attractive growth opportunities, given their lower insurance penetration
rates and potential for economic expansion.

Through international growth and diversification strategies, insurers become exposed
to new and unique risks, as well as integration, cultural and regulatory considerations.
Integration issues can be significant, since US-based companies would have to adapt to
different cultures, systems, and accounting and reporting standards. Exposure to new
regulatory systems also requires companies to adjust their risk management approaches.
Currency and political risks are other elements that can affect an insurer’s profitability.

Many insurers look to gain a competitive advantage by finding market niches in which to
specialize. The development of new technologies across all industries could lead to new
opportunities for insurers to discover and ply these niches, given the emergence of a
larger pool of insurable risks. The rising demand for protection from emerging risks in new
technologies offers insurers an opportunity to gain significant market share and make a
profit. Nevertheless, the loss uncertainties and other unknowns associated with emerging
risks present challenges to modeling, product pricing, coverage design and underwriting.
Since emerging risks tend to focus on newer causes of loss, this suggests that underwriting
assumptions will be based on limited historical data. Additionally, coverage terms are
relatively untested, creating a policy language.

US property/casualty insurers will need to rely on extensive research, innovation and
expertise to profit from these new markets, whether geographical or technological. As such,
expansion strategies insist that carriers obtain new execution and monitoring capabilities,
either internally or through arrangements with qualified business partners.

Multi-line insurers also may seize premium growth opportunities by cross-selling their
products to customers. According to Ernst & Young’s 2012 Global Consumer Insurance
Survey, roughly half of the consumer population prefers to buy multiple products from the
same provider, citing convenience and value as the key factors. Despite this preference,
most insurance companies do not take advantage of opportunities to market additional
policies to their clients. Cross-selling products can improve profitability and increase
customer retention. By using marketing data to target those consumers most likely to buy
multiple insurance policies, insurers can leverage opportunities to expand their businesses
and increase retention over the long term.
Contacts

Shaun Crawford
Global Insurance Leader
Email: scrawford2@uk.ey.com
Tel: +44 207 951 2172

David P. Hollander
Global Insurance Advisory Leader & Americas Insurance Co-Lead
Email: david.hollander@ey.com
Tel: +1 215 448 5756

John P. Santosuosso
Global Insurance Assurance Leader & Americas Insurance Co-Lead
Email: john.santosuosso@ey.com
Tel: +1 617 585 1867

Paul Clark
Asia-Pacific Insurance Leader
Email: paul.clark@au.ey.com
Tel: +61 2 9248 5555

Andreas Freiling
EMEIA Insurance Leader
Email: andreas.freiling@de.ey.com
Tel: +49 6196 996 12587

James Littlewood
Latin America
Email: james.littlewood@ey.com
Tel: +1 305 415 1849

Terry Jacobs
Global Insurance Tax Leader
Email: terry.jacobs@ey.com
Tel: +1 202 327 8705

Mike Davies
Global Insurance Actuarial Leader
Email: mdavies2@uk.ey.com
Tel: +44 20 7951 0531

David Lambert
Global Insurance TAS Leader
Email: dlambert@uk.ey.com
Tel: +44 20 7951 9848