2015
Global insurance outlook
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Executive summary
In 2015, the macroeconomic environment across much of the world shows significant improvement, with GDP rising in many countries and both the middle class and high net worth populations expanding in number and financial resources. These factors bode well for international property-casualty and life-annuity insurance companies.

Key challenges in 2015 include rising competition, generally soft pricing conditions and tight profit margins. To effectively surmount these problems, many insurers are investing technological solutions that improve front-end sales, distribution and customer service, and enhance back-end operational efficiency and expense management.

If one word could sum up the focus of insurers in 2015, it is “technology.” Many insurers are investing in digital platforms that strengthen their relationships with customers across all product classifications and geographies. Their goal is to empower both businesses and consumers to better shop for insurance, making products more transparent, easier-to-understand and compare.

Across all regions, insurers are capitalizing on data analytics, cloud computing and modeling techniques to sharpen their market segmentation strategies, reduce claims fraud and strengthen underwriting and risk management. They are also investing in technology solutions to optimize processes, increase collaboration across the enterprise, and demonstrate capital adequacy and financial solvency for regulatory compliance purposes.

Now that much of the world has returned to more stable economic conditions, it makes eminent sense for property-casualty and life-annuity insurance companies to invest in digital solutions that widen margins and provide competitive differentiation. But, technology is a two-edged sword, as the shocking number of data breaches clearly demonstrates. Thus, one last important “spend trend” in 2015 for international insurers—cyber security.

Our comprehensive Global insurance outlook explores the various challenges and opportunities confronting global insurance organizations in 2015. In this report, we offer our perspective on the property-casualty and life-annuity insurance markets in Asia-Pacific, Canada, Europe, Latin America, and the United States.
The challenges and opportunities by region

- Although insurers in Asia-Pacific are likely to confront deteriorating economic conditions in 2015, growth prospects remain solid for life and non-life insurance products, with GDP projected to be 5.5%.
- Rising real estate and financial asset values are enabling insurers throughout the region to produce higher premium volume from the increased protection levels.
- The growth of the middle class and high net worth population in Asia-Pacific presents the opportunity for insurers to increase their sales of personal lines insurance products, as well as health insurance.
- Commercial lines insurance prospects remain strong, given the region’s elevated catastrophe risk, the rise in infrastructure and home building across much of Asia-Pacific, and a low insurance penetration rate.
- Insurers are challenged to invest in data analytics and modeling capabilities, as well as Internet and mobile digital sales, distribution and customer service solutions, given an increasingly technologically sophisticated population.
- Regulations addressing insurer solvency, capital and risk management are moving to the front burner, in addition to consumer protections in the areas of data privacy and security.
**Canadian property and casualty**

- Profit margins for property-casualty insurance companies in 2015 are challenged by continuing low-interest rates and GDP growth, the volatile investment climate and expense increases from needed infrastructure improvements.

- A major competitive opportunity for insurers is to strengthen their relationships with customers, effectively putting them in focus across all product classifications and geographies, while digitally empowering them to better shop for and compare insurance products.

- A key challenge in 2015 for Canadian property-casualty insurers is to improve the industry’s low level of consumer trust by integrating distribution and communication channels and providing more transparent information.

- Opportunities to improve both commercial and personal lines sales and optimize growth are available to insurers that invest in technologies, such as cloud computing, mobile solutions and business collaboration software.

- Building an enterprise data excellence infrastructure via more robust data analytics and predictive modeling will help insurers pinpoint new growth opportunities, optimize claims outcomes, reduce the incidence of claims fraud and mitigate bottom line risks.

- Regulatory pressures in 2015 include demands on property-casualty insurers to become more disciplined in their risk management, capital planning and operational oversight, while producing demonstrable evidence in these areas.

**Canadian life**

- Although providers of life insurance and annuities in Canada have endured several years of constrained growth, opportunities exist to improve competitive standing by providing products to underserved consumer markets.

- A key challenge for insurers in 2015 is the need to develop more robust mobile digital technologies, data analytics and social media strategies to address growing consumer expectations of more refined product sales and distribution.

- To boost sales revenue, providers of life insurance and annuities in Canada must make their products easier to understand and compare, in addition to streamlining the transaction process.

- To enhance customer experience and enable self-service features, life insurers must consider the value of a digital platform enabling the sharing of information with and among intermediaries and consumers.

- A key opportunity in 2015 for life insurers is to develop solutions absorbing the longevity risks of pension plan de-risking actions, which are driven by improvements in life expectancy and the low-interest rate environment.

- Regulatory pressures continue to intensify, putting the onus on life insurers to improve their compliance and control functions, implementing more robust governance programs to address key business risks.
European insurers will continue to be challenged on both sides of the balance sheet in 2015, as economic recovery throughout the region is overshadowed by low business investment rates, slower global growth and heightened competition in many classes of business.

There is a greater responsibility for insurance companies to interact with the customer, provide a range of digital communication channels, encourage loyalty and brand awareness, and tailor products and services to individual needs.

A growing number of insurers are scaling up their analytical capabilities to be in a better position to use data in a more connected way, drawing meaningful insights at virtually every stage of the insurance life cycle from customer targeting to product design and pricing, underwriting, claims and reporting.

Regulatory initiatives will require greater transparency regarding the information provided to customers, revisions to relationships with distributors and greater governance and oversight over new and existing products.

Finance is under pressure to show it can be a better business partner in planning, budgeting and forecasting, adding more value while also responding to regulatory requirements and tax challenges.

Insurer growth prospects are generally favorable, although market demand for property-casualty and life insurance products is evolving at different rates, given disparate economic factors across the region.

The expansion in Latin America’s middle class and high net worth populations, as well as the region’s technologically savvy younger generations, create opportunities for providers of automobile insurance and mobile technology warranties.

As more homes and office buildings are built throughout the region, the need to insure these structures from the damaging effects of natural disasters is a positive trend for commercial property and homeowners insurers.

A key challenge for many insurers in 2015 is the need to modernize their operations and distribution models to adapt to rising business and consumer expectations of digital, mobile and Internet interactions, particularly for commercial lines of insurance where intermediaries retain control.

On the regulatory front, regions are addressing global standards on capital solvency and risk management on different timetables, putting the onus on insurers to continually monitor and evaluate these developments to exploit a competitive advantage.

As competition throughout Latin America intensifies in 2015, insurers that best leverage data analytics and predictive modeling techniques to improve their underwriting and management of risks have the opportunity to make more profitable business decisions.
**US property-casualty**

- Despite slow-to-rebound interest rates and inflationary medical and food costs, strong performance for US property-casualty insurers is expected, with combined ratios returning to pre-financial crisis years.
- A key challenge includes slow premium growth, which continues to be inhibited by rising competition, an overabundance of capital, and inexpensive reinsurance, the latter a consequence of low insured catastrophe losses the last two years.
- The soft pricing conditions is constraining profit margins, compelling insurers to focus on expense management and operational efficiency, reducing costs through technology upgrades, process optimization, selective offshoring and enhanced risk management.
- The use of data analytics and modeling techniques to improve underwriting and back office processes remains a potent opportunity for US property-casualty insurers to bolster their competitive standing.
- On the distribution front, insurers will optimize the channel mix, adding distribution outlets and expanding aggregator and direct-to-consumer models, while providing consumers with enhanced product price transparency and real-time support and service.
- To address the evolving array of capital solvency and risk management regulations, and achieve compliance with different US regulatory authorities, property-casualty insurers will need to invest in more skilled management and data analytics resources in 2015.

**US life-annuity**

- Growth prospects are promising for US providers of life insurance and annuities, as the overall economy improves, consumer wealth increases and interest rates creep higher.
- Key challenges in 2015 include growing competition, especially from new capital entrants seeking to disrupt traditional market positions with new models and market approaches aligning with rising customer expectations.
- To succeed in this environment, providers of life insurance and annuities must expand their digital capabilities with new Internet, social media and mobile tools that empower customers and distributors with self-service features, while also making insurance products easier to understand, compare and buy.
- A major opportunity to widen margins exists for insurers that leverage big data and the cloud to transform back offices systems and processes, albeit these decisions must be weighed against the cyber security risks and regulatory issues they present.
- As many consumers turn to online banking and investment services to manage their finances, they will seek similar opportunities from providers of life insurance and annuities, presenting opportunities for insurers that develop online advice and transactional models.
- A continuing challenge in 2015 is the ability of providers to navigate the wide array of complex capital solvency and risk management regulations enacted in the aftermath of the financial crisis and overseen by competing regulatory authorities with different demands.
Asia-Pacific

Technology is accelerating mobile and web-based opportunities
Market summary

Although Asia-Pacific insurers are likely to face diminishing economic growth in 2015, affecting demand for life and non-life insurance products, overall gross domestic product (GDP) growth nonetheless is forecasted to be 5.5% in 2015, according to the International Monetary Fund (IMF). This rate is well above forecasted growth in the US and European Union (EU). Consequently, the region’s continuing appeal to foreign insurers seeking growth opportunities remains strong.

The region’s economic growth will be driven, in part, by rising exports to the US and the EU as these economies recover. Since Asia-Pacific is exposed to growth shocks originating in China, that country’s decelerating growth in 2015 may affect trading partners such as Republic of South Korea and Vietnam, potentially curtailing stronger GDP growth across the region.
Another issue is possible interest rate changes, which could affect insurer portfolio returns and product pricing. Various countries may experience a rise in interest rates in response to higher global rates, potential stimulus measures by Japanese and European central banks, and efforts to control domestic inflation. However, both China and Vietnam are expected to reduce short-term rates. This may offset overall conditions and contribute to opportunities in the region for insurers.

Rising real estate and financial asset values generally are enabling insurers to generate higher premiums for increased protection levels. Nevertheless, if the U.S. Federal Reserve continues to reduce liquidity in 2015, real estate and financial asset price volatility may increase, as it did in 2013 and early 2014.

The IMF suggests an emerging risk to domestic demand is growing household indebtedness, with significant house-price corrections possible in Hong Kong SAR, New Zealand and Malaysia. Large declines should not be ruled out in other economies, particularly in cities where prices have grown much faster than rents. Nevertheless, past history indicates the actual effect of home-price reductions on wealth may be modest.

The growth of the region’s overall economy, middle class and high net worth (HNW) population offers enhanced opportunities to sell personal lines, commercial lines and health insurance. The middle class numbers 525 million people, more than the population of the EU. Roughly one-third of the world’s middle class today, it is expected to represent more than half the world’s middle class by 2020. As consumer wealth rises and more sophisticated financial advice and solutions are sought, the potential for premium from the sale of personal lines insurance to protect homes and automobiles increases.
In this evolving environment, insurers in Asia-Pacific will need to consider the following adjustments to their service, products and compliance efforts in 2015:

1. Streamline the value chain via the cloud and traditional business process outsourcing (BPO)
2. Expand products and services to address the growing needs of the HNW market
3. Adapt product strategies to the changing regulatory environment
4. Increase compliance to respond to growing sales and consumer protection regulations
5. Develop capital and M&A opportunities
6. Reposition investment strategies
7. Enhance data controls and metrics

Similarly, rising GDP increases commercial insurance exposures and the need for protection against conventional business risks, as well as property, catastrophe and business interruption and extra expense exposures. Eight of the 10 countries in the world with the highest annual natural catastrophe losses as a percentage of GDP are located in Asia. The region’s elevated catastrophe risk, economic growth and low insurance penetration (premiums as a percentage of GDP) create significant opportunity for commercial lines premium growth.

The opportunity to offer private health insurance in Asia-Pacific is also expanding, due to rising individual income levels and government budget constraints. In China, the health insurance market is growing strongly as consumers turn to the private sector to fill in the gaps left by inadequate government schemes. Ping An Health (Ping An), for instance, reported that it was signing up 300 to 500 new lives a day. India is another promising market for personal health insurance; only 15% of the population is covered by government health insurance and 2.2% by private health insurance.

Technology is accelerating mobile and web-based sales, advice and distribution opportunities in the region, which touts high levels of mobile device ownership and usage. Approximately 80% of customers are willing to use digital and remote contact channels for different types of interactions with their insurers. In 2015, non-life aggregators will continue to emerge and offer insurance products directly to consumers, and some life insurers will look beyond traditional agents to distribute products to middle-market consumers.

The Monetary Authority of Singapore will launch a web aggregator for life products; Banka Negara Malaysia recently announced a similar initiative. At the same time, underwriting and administration systems will continue to evolve, driven in part by analytics and telematics, enabling insurers to effectively and profitably reach a broader consumer profile.

On the regulatory front, regulations that protect consumer data, strengthen insurer capital and address mergers and acquisitions (M&A) continue to emerge at local, regional and international levels. The regulatory agenda varies from financial system liberalization in China to reforms in India.

Consumer protections are extending beyond sales compliance to encompass data privacy and security. This evolution may slow insurer development of cloud-based technologies, efforts to deliver mobile sales and service applications, the increased use of telematics, back-office streamlining initiatives and regional reporting and risk management efforts.

Many countries also are considering tax reforms to sustain growth, maintain investor confidence and secure financial stability. In China, for example, ongoing VAT developments may address financial services, with a potential impact on insurance sales.

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Streamline the value chain via the cloud and traditional BPO

Successful insurers in Asia-Pacific in 2015 will streamline their value chain through cloud-based solutions and BPO. This is driven by a need to more efficiently deliver and administer products and services, respond to increasing competitive pressures on product margins and address rising regulatory reporting demands.

Efforts by some countries within the region to develop infrastructural and regulatory support for cloud development will accelerate usage of cloud-based solutions. China, for example, is pro-cloud development and, while its infrastructure is behind the regional curve, cloud adoption will grow as wireless access increases. Singapore is an early adopter of cloud solutions in terms of infrastructure. In Malaysia, data management policies and big data analytics projects position it for strong cloud development. Companies across diverse industries in the Philippines have migrated operations to the cloud at a rate that has doubled between 2011 and 2014. Other countries in the region are likely to follow these market leaders.

Insurers may take advantage of the growing availability of cloud computing analytics to reduce costs and standardize systems. Last year, Ping An partnered with IBM to develop a new cloud-based data storage solution that accelerated Ping An’s ability to collect data from its various databases from one month to one hour. This enabled Ping An to improve regulatory compliance and perform enhanced data analytics to improve pricing and profitability.

To further streamline the value chain in 2015, BPO is another growing approach. Some insurers will look to outsource operations to third-party service providers in regional BPO centers in the Philippines, India and China. Knowledge process outsourcing (KPO), the outsourcing of high-end activities and white-label support services, also is rising, particularly in knowledge-intensive sectors such as insurance.

Outsourcing will be under close monitoring by ASEAN regulators, which are checking data privacy and consumer protection. For example, the Monetary Authority of Singapore issued a consultation paper in 2014, advising the establishment of minimum outsourcing management standards.

India will continue to lead the offshore sourcing industry, but emerging destinations intend to increase their share of this market. In the Philippines, where call center BPO has been a major focus, non-voice BPO and KPO are catching up with the voice segment. According to the Philippine IT-BPO Roadmap 2016: Driving to Global Leadership, a report commissioned by Information Technology and Business Process Association of the Philippines (IBPAP), voice services fell from 65% to 60% of total outsourcing in the first half of 2014. IBPAP expects non-voice BPO services, including KPO and engineering services, to grow at about 20% in 2015.

In 2015, insurers will need to identify how they can best take advantage of both cloud-based and traditional solutions. Some insurers need to standardize their current data and systems. Others have to adjust their internal business processes to integrate them with external cloud-based or traditional outsourcing solutions. Many insurers must develop metrics and processes to measure the return on investment (ROI) of their streamlining initiatives.

Expand products and services to address the growing needs of the HNW market

Rapid growth in the HNW segment in Asia-Pacific, accompanied by the growing need to protect newly acquired assets, will stimulate further demand for savings and personal insurance products in 2015. Consumers also will seek financial advice and distribution methods matching their increasingly mobile and web-based lives.

The development of products to protect against the loss of accumulated assets and personal property will grow in 2015. Most HNW individuals in the region are first- or second-generation business owners, who need to finance their businesses, separate and protect their personal wealth and provide for their family’s financial security. Their portfolios are often concentrated in domestic Asian markets. With economic volatility a possibility, some HNW investors have reduced their positions in high risk, high-return products and increased their
allocations in moderate- and low-risk investments. This altered diversification has increased the sale of high-value life insurance policies to the HNW segment.

Many HNW consumers also invest in tangible assets such as real estate, given the region’s fast-changing property price increases. Nevertheless, many Asia-Pacific markets remain woefully underinsured in terms of non-life protection, presenting an opportunity for insurers and reinsurers to provide coverage for catastrophe perils and business income protection.

Serving the needs of HNW consumers may lead insurers to adjust their distribution models. An example is introducing or enhancing bancassurance distribution. In 2014, Citibank (China) Co., Ltd. and AIA China (AIA) announced a new bancassurance partnership, combining Citibank’s advisory capabilities and AIA’s life protection solutions. The same year, Prudential Plc and Standard Chartered extended their current agreement for another 15 years, while Security Bank Corp. entered a bancassurance partnership deal with the FWD Group, the insurance arm of Hong Kong’s Pacific Century Group.

Consumers in Asia-Pacific are more willing to shift to digital channels than consumers in any other region globally, according to EY’s Global Consumer Insurance Survey 2014. Investing in mobile digital advice and service solutions thus becomes another key distribution strategy. Many HNW consumers want to have digital interactions that keep them informed and enable transactions.

Direct marketing of term life insurance and small business insurance (e.g., professional liability cover) is becoming more prevalent, even in emerging Asia-Pacific economies where sales typically occur via intermediaries. Many Asian insurers have also developed advanced direct online platforms. As these new distribution channels emerge, insurers will need to manage multiple touch-points with their consumers. They also need to address the impact of the changes on branding and compliance.

Adapt product strategies to the changing regulatory environment

The changing regulatory landscape in 2015 will create more cross-border sales opportunities for insurers. Countries such as China and the Republic of South Korea will continue to reform their pension systems and rules governing where individuals can accumulate retirement assets – within their home country or outside it. Indonesia recently reformed its health system to ensure that every person is insured. To take advantage of sales opportunities, insurers must manage these regulatory and administrative challenges.

Cross-border sales are growing for some insurers as more consumers purchase products outside their home jurisdiction, where the cost may be higher. In Hong Kong SAR, for example, mainland Chinese often cross the border to buy investment-linked assurance schemes (ILAS). Private bank Julius Baer, which predicts the number of mainland Chinese HNW consumers will reach 1.4 million in 2015, indicates that the majority have either engaged in cross-border investments or have considered it.

Regulatory changes continue to favor the creation of cross-border sales in 2015. For example, the ASEAN Framework for Cross-Border Offering of CIS (Collective Investment Scheme) became effective in August 2014 with three initial member jurisdictions – Singapore, Thailand and Malaysia. Singapore signed a Statement of Intent with the Republic of South Korea, Australia and New Zealand to establish the Asia Region Funds Passport (ARPF) in 2013, with a target date for implementation in January 2016. Thailand and the Philippines have expressed their intention to become part of the ARPF. Other regulatory developments include the Hong Kong-Mainland China Mutual Fund Recognition Scheme and the November
Increase compliance to respond to growing sales and consumer protection regulations

Regulators remain concerned about improper product sales by agents and the consequences of insurer insolvency. Insurers need to consider current and developing distributor disclosure initiatives to avoid reputational risk and heighten standards across the distribution chain, from the content of advertising material to distributor sales training and professional knowledge.

Numerous instances of misinformation and opaque sales practices, causing financial losses for policyholders, have increased regulatory attention. A case in point is the distributors’ inadequate disclosures of high fees and charges associated with early termination of the Hong Kong ILAS product. Regulators responded by requiring, or strengthening upfront, disclosures regarding distributor remuneration, all fees and charges and the investment’s risk factors. In China, regulators are reviewing and inspecting intermediaries to identify improper sales practices, misappropriation of funds and unauthorized funds. And in Singapore, Financial Advisory Industry Review (FAIR) will undertake an independent audit of insurance sales and compliance practices.

Other countries are also tightening distribution supervision. India’s IRDA has introduced requirements for distributors to present benefit illustrations to policyholders. New regulations in India also set limits on

2014 alignment by the Shanghai and Hong Kong stock markets to promote intra-Asian financial transactions.

Insurers seeking cross-border market opportunities need to manage these developing regulatory standards and prepare for emerging rules. Given the wide range of regulatory standards and differing expectations across the region, rules are sure to contain nuanced differences. For example, some regulators may resist the introduction of passporting schemes, due to the inclusion of jurisdictions that may not appear to have a comparable level of regulatory supervision. The potential of

less than adequate legal frameworks, non-uniform accounting and auditing standards, poor transparency and weak corporate governance in less-developed member economies will remain key challenges for insurers in 2015.

There are also tax implications to consider in the development of cross-border sales. A case in point is the mutual fund recognition agreement signed between Hong Kong SAR and Australia that curtailed the tax advantages for Australian investors investing in offshore funds. Similar restrictive taxes on offshore funds also apply in the Republic of South Korea, making it prohibitive for offshore funds to enter this market. The Common Reporting Standard expected to be in force across most of the region by 2020 will add more complexity to both cross-border sales and the reporting of financial information.

Insurers best equipped to manage these challenges will benefit from potentially significant sales increases. For example, the ASEAN passport offers access to three possible Asian passport/mutual recognition regions in Singapore, Thailand and Malaysia. Asset managers in those countries collectively managed approximately US$204 billion at the end of 2012, with the assets under management in ASEAN as a whole totaling approximately US$286 billion in December 2013. Mainland China constitutes the largest market of retail fund investors, which explains the growing anticipation surrounding the Hong Kong-Mainland China Mutual Fund Recognition Scheme.
commissions and establish appropriate insured financial limits and surrender values based on an insured's age. In Indonesia, where the number of life insurance agents is expected to increase to 500,000 in 2015 from 300,000 in 2014, no agent has ever had a license revoked, suggesting that there is a clear need for regulators to ensure professional standards.

Regulators in the region are also strengthening their prudential supervision to protect policyholders in the event of insurer insolvency, given past failures. Australia's Australian Prudential Regulation Authority, for instance, has taken actions to encourage disciplined risk management. Singapore has strengthened policyholder protections following a run on insurers during the financial crisis. International efforts on the part of the International Association of Insurance Supervisors for consistent approaches to policyholder risks is driven by the dizzying pace of growth for insurers in Asia-Pacific, which may increase the risk of their failure in the event of a severe economic downturn.

Develop capital and M&A opportunities

The introduction of stronger capital requirements and reduced foreign investment restrictions across the region will likely act as a catalyst for consolidation of smaller insurers in 2015. Collateral impact from Solvency II rules may also create pressures for banks to divest affiliated insurers, given changing views on bank-insurance linkages. As these pressures influence banks in Australia, the market changes could be significant because the bank-owned insurers are among the largest in the country. In Malaysia, recent bank mergers may disrupt long-standing relationships between banks and insurers, encouraging a review of existing bancassurance agreements.

The factors contributing to the region's attractiveness for insurers will continue in 2015. Historical obstacles to entry, in the form of restrictions on foreign ownership and on allowable investment classes, are becoming less of an issue, given recent reforms. This more relaxed posture is likely to stimulate M&A activity in the region.

China's CIRC rule, for example, permits investors to have an ownership stake in more than one insurance company providing similar products. This change is likely to encourage foreign insurers to invest in the Chinese market. A new rule allowing the use of external debt by investors to finance acquisitions also may spur additional investments in the market, as may the rolling back of the prior requirement for investors to have a minimum of three years' experience in the insurance sector. In India, the recent increase in the maximum allowable ownership of insurers from 26% to 49% is likely to stimulate additional investment in the market sector, which is in great need of capital and product and service innovation.

Pressures to maintain domestic control of insurance and reinsurance markets continue to exist across the region. In Indonesia, a state reinsurer is being created out of existing local reinsurers with enough scale to compete against foreign reinsurers. Indonesia also introduced new insurance regulation in September 2014 to increase local ownership of insurers, while Singapore's regulators are willing to provide new licenses to develop the life and health insurance markets.

China continues to maintain restrictions on offshore reinsurance cessions. Reinsurers will continue to evaluate the region's considerable opportunity, despite these restrictions. They will also explore how data analytics and technology can enable them to underwrite and manage risk effectively, given the region's inherent risks.

Several large, strong Asian insurers and investors will continue to extend their reach beyond Asia into other regions. Cross-border transactions in 2014 included Fosun's acquisition of Caixa Seguros in Brazil, Orix's acquisition of Hartford Life and Dai-Ichi Life's acquisition of Protective Life. Recent moves into Lloyd's of London include China Re's syndicate 2088 (turnkeyed by Catlin), India's GIC Re and Malaysia's Labuan Re.

Reposition investment strategies

The changing regulatory environment and more volatile investment markets are compelling insurers to alter their investment strategies in 2015. For example, greater investment in real estate is encouraged
Enhance data controls and metrics

Data theft and fraud are fast becoming key issues for regulators and law enforcement across Asia-Pacific, as elsewhere. Insurers are paying close attention to the new data privacy rules being drafted in response to the increased risks. Regional and global insurers with operations in the Asia-Pacific region also are grappling with the issue of data sovereignty – which can be transmitted among jurisdictions – as the data privacy regulations vary across the region. More stringent data protection rules in Australia and Singapore also may create questions about the identity of countries in which insurers store their data. A subpoena issued by a government to an insurer to provide certain data requires knowledge of where it has been physically stored. Insurers also will need to identify new metrics and processes to monitor data security and compliance.

Many insurers in the region will continue to enhance their data controls in 2015, prompted primarily by new and stricter regulations. Asia-Pacific insurers must pay closer attention to the changing cybersecurity laws and focus more stringently on data security, network crime legislation and law enforcement. Singapore’s Personal Data Protection Act, for example, includes rules on the collection, use, disclosure and care of personal data. The law establishes penalties for breaches and a "Do Not Call" registry. China, Indonesia, Japan, Thailand and Vietnam also are reviewing legislation and drafting bills or have set up government agencies and task forces to confront cybercrime.

Insurers will need to review and adjust to consumer and distributor data privacy controls as regulations continue to evolve.

by the new regulatory posture. With the exception of Taiwan, where real estate accounts for 4.8% of insurers’ investments, real estate holdings constitute a low percentage of insurers’ investments, ranging from 1% for Chinese insurers to 2.5% for insurers in South Korea. This compares to 5% for developed market insurers. Recent regulatory changes in these three countries now permit higher allocations to domestic real estate. They further invite insurers in the countries to explore opportunities in investment-grade properties in North America, Europe and Australia. Growth in Asian insurers’ assets also is expected to increase real estate investments, especially among insurers in China and Taiwan. As these actions progress, insurers must endeavor to understand complex tax and capital outflow considerations and investment channel choices.

Insurers also are expected to rebalance their portfolios, moving away from traditional holdings in sovereign bonds and short-term deposits into alternative asset classes such as global equities, corporate credit, illiquid assets and currencies. While the change may provide a higher return, it must be balanced against tax, capital charges, investment compliance and other regulatory considerations. Consequently, insurers pursuing these asset classes in 2015 will need guidance from in-house expertise or external counsel.

As insurers rethink their investment strategies, they are evaluating strategic asset allocation (SAA) and dynamic financial analysis (DFA), two quantitative disciplines to identify efficient frontiers in light of the changing risk-and-return dynamics. Insurers that find they lack the appropriate skills in-house for asset-liability matching will likely partner with external providers of these services. And the potential uptick in interest rates across some countries in the region is encouraging insurers to examine portfolio reallocation and interest-rate hedging programs to improve their investment returns.
### Asia-Pacific country forecasts

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Sources: * EY Rapid-Growth Markets Forecast, July 2014  
** Organization for Economic Co-operation and Development (OECD) and trading economics  
Canadian life-annuity
Entering a new era
Market summary

Based on our 2014 Global Insurance CFO Survey, the top business drivers for life insurers around the world over the next few years will be to achieve growth, relieve pressure on costs and margins, improve profits and respond to regulatory change (as shown in figure 1). These challenges are evident in Canada’s life insurance and annuity industry.

Despite several years of slow-to-no growth for providers of life insurance and annuities in Canada, multiple opportunities to gain competitive stature beckon nonetheless. Successful providers in 2015 will develop strategies to provide products to developing consumer markets that are currently underserved. Examples include the growing, yet unmet, financial protection and savings needs of the mid-market sector and Generations X and Y.
External forces in 2015

<table>
<thead>
<tr>
<th>Interest rates and economic factors</th>
<th>Consumer trust</th>
<th>Customer needs</th>
<th>Technology changes</th>
<th>Regulations</th>
<th>Capital adequacy</th>
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</thead>
<tbody>
<tr>
<td>Slight interest rate rise but still near lows, slow economic growth</td>
<td>Middling consumer trust</td>
<td>Needs and expectations increasing rapidly</td>
<td>Pace of change dramatic</td>
<td>Steady increase and new regulators appearing</td>
<td>Capital rebuilt and continued accumulation</td>
</tr>
</tbody>
</table>

To effectively serve these markets and address rising consumer expectations, growth-oriented providers will incorporate new approaches using digital technologies, data analytics, mobile tools and social media.

Consumers seek life insurance and annuity products that are easy to understand and compare, and can be acquired in a streamlined transactional environment. Digital solutions promise this greater efficiency, but many providers have yet to embed technology as an integral part of their culture, and hire the talent to implement it.

In 2015, the onus is on providers to integrate data analytics with customer experience, underwriting, market segmentation and acquisition, risk-based pricing, distribution strategy, claims optimization, liabilities valuation and reporting. More insurers need to consider the value of an omni-channel distribution platform to interact and transact digitally with brokers, agents and consumers; encourage self-service customer experiences; and achieve cross-selling opportunities.

At the same time, providers must contend with growing regulatory pressures to enhance their compliance and control functions. Insurers must demonstrate that they have implemented sound governance programs to address their organizations’ key risks and functions.

Canadian life insurers and annuity providers that recognize the forces of change and take quick action to leverage market opportunities will improve their competitive positions in 2015.

In this regard, insurers must consider the following actions:

- Reposition to address underserved markets
- Invest in digital and analytics
- Proactively address the new regulatory regime
- Enhance data security

Reposition to address underserved markets

While the life and annuity market has been a low-growth to no-growth market for a number of years, there are a number of underserved and developing areas of opportunity. These include the unmet financial protection and savings needs of the mid-market segment and Generations X and Y, which continue to grow.

Traditional insurance products and distribution channels generally are not well suited to these markets. Although the high net worth (HNW) market drives sales and attracts distributor attention, the challenge for insurers is to execute an efficient strategy that targets underserved markets without disrupting the HNW mainstay.

There are significant opportunities for insurers willing to adapt their strategies. Consumers in Generations X and Y are much more likely to do their own research on insurance products using a variety of sources and, in particular, the internet.
Since many insurance agents face the same digital challenges, collaboration is key. Insurers need to equip intermediaries and agents with powerful technology tools, improve customer relationships at multiple touchpoints and minimize channel conflicts.

By providing life insurance and annuities to these markets in ways they want to access and evaluate the products, insurers may be able to improve the industry’s reputation. Consumer trust is a major challenge for providers. Only 59% of Canadian consumers trust life insurance companies, according to our *Global Consumer Insurance Survey 2014*. This percentage lags the trust accorded other industries like banks, may one day evolve into significant online sales and distribution systems that target consumer segments via websites, mobile apps and online videos.

Insurers need to embrace an omni-channel approach and develop a digital platform to interact and share information among agents, brokers and consumers. The availability of customer information across channels is a baseline requirement to enable more self-service and enhanced customer experience. Providing consumer data to any channel across any product and easing the transfer across multiple channels open the door to cross-selling opportunities.

Simplified products will be more easily understood and valued by these consumers and should also be attractive to the mid-market. By doing this, companies may be able to correct the relatively high expenses that have made these markets difficult to serve in a financially appropriate manner.

Providers also must explore a more direct-to-consumer approach for next-generation markets, leveraging streamlined underwriting processes that involve data analytics. A streamlined underwriting approach should result in a faster issuing process, higher take rates and lower expenses. By making these investments in 2015, providers can build capabilities that may one day evolve into significant online sales and distribution systems that target consumer segments via websites, mobile apps and online videos.

Figure 1: Primary business drivers

Question: Please rank in order the following business drivers facing your organization through 2020

Percent of respondents ranking the driver among the top three

Achieving growth, expanding into markets and/or expanding through M&A activity: 43%, 26%, 11%, 9%

Relieving pressure on costs and margin and improving profit: 51%, 20%, 11%, 6%

Responding to regulatory change: 54%, 20%, 11%, 3%

Improving capital and liquidity position: 31%, 11%, 3%, 2%

Addressing competition from globalization and new market entrants: 31%, 11%, 9%, 3%

Establishing risk mitigation and management: 29%, 6%, 3%, 2%

Increasing simplification through organizational restructuring: 17%, 14%, 11%, 9%

Preparing for leadership change and succession: 18%, 9%, 3%, 3%

Other: 18%, 3%, 3%, 3%

Order of priority:
- First
- Second
- Third

Source: EY Research, 2014

While growth is currently the top business driver, regulation and cost pressures are expected to remain as top priorities for the foreseeable future.
Longevity insurance and/or longevity swaps may represent very good opportunities for insurers willing to enter these emerging markets.

online retailers, supermarkets, automobile manufacturers and pharmaceutical companies (see Figure 2). Canadian results also compare unfavorably to both the global and US results.

Insurers that stay on the sidelines as others make these investments to serve next-generation markets risk losing existing customers, while limiting their opportunities to connect to new customers and missing out on cost-effective opportunities to enhance the overall customer experience.

Another market opportunity for life insurers is pension plan de-risking. The life expectancy of Canadian pensioners continues to increase. The improvement in mortality rates, in addition to low interest rates and regulatory changes, is increasing the cost of funding defined benefit pension plans. Pension plan administrators are searching for methods to mitigate the risks underlying the plans while many corporations seek ways to transfer some of the longevity risk to third parties.

Annuity buyouts and buy-ins are the most common transactions. These strategies, which involve the transfer of investment and longevity risks, are growing in use. Newer risk mitigation strategies include longevity insurance and longevity swaps, which protect against mortality improvement and longevity risks.

The high interest in Canada to de-risking pension plans prompted the Office of the Superintendent of Financial Institutions in June 2014 to publish a policy advisory on longevity insurance and longevity swaps. The document provides information and guidance to administrators of federally regulated defined benefit pension plans mulling these various strategies.

While these concepts are fairly new in Canada, a number of these transactions have occurred in the UK over the last few years. The UK longevity market is relatively mature, with both sellers (corporations with pension plans) and buyers (the insurance companies providing the longevity insurance) considered knowledgeable about the structures and the pricing necessary to complete these arrangements. Given that there are more than US $1.1 trillion of defined benefit pension plan liabilities in Canada, expectations are for continued development in 2015.

Longevity insurance and/or longevity swaps may represent very good opportunities for insurers willing to enter these emerging markets. Nevertheless, due consideration must be given to the regulatory landscape, and the associated risks must be carefully assessed and managed.

Invest in digital and analytics

Digital is a new market force that is driving a massive change in consumer expectations. It will require a different set of skills, culture and measurement. While other industries have already harnessed digital to attract and retain customers, providers of life insurance and annuities in Canada are not yet where they need to be. Providers have struggled with uneven data capture and analysis of consumer online activities, as well as their ability to present a consistent digital customer experience.
Top-performing insurance companies in 2015 will have stronger digital capabilities, as well as new skills, refined metrics, upgraded tools and reoriented cultures. Insurers must move fast because in the digital world, standing still or just keeping up means falling further behind.

Insurers are currently lagging behind the digital curve, and conditions for future success are not yet in place. As a result, many providers struggle to deliver products to customers’ expectations. New market entrants and digitally leading competitors certainly will seek to exploit this failing. While the marketing, sales and service opportunities are obvious in a digitized environment, the underwriting, claims, finance, risk management and IT impacts are just as significant.

The goal is to give next-generation customers what they want, where they want it and when. To do this, providers must make key operations and back-office functions more efficient and agile. What may seem innovative and next-generation today, such as submitting claims via tablets or making offers via social media, will be standard operating procedure tomorrow.

By delivering superior and homogeneous customer experiences across all digital touch points, and effectively capturing and analyzing online consumer behaviors, successful insurers will achieve competitive differentiation in 2015.

Analytics and big data represent major opportunities for life insurers. Personal data is the new economic asset class of the 21st century. Massive data volumes are now available to insurers. Public information about customers’ lifestyles and online experiences is increasingly accessible. Synthesizing and analyzing this large amount of internal and external data require new tools like predictive analytics and modeling methods.

Customers also are demanding a more personal experience in their transactional events. The ability to identify customer behaviors and risk profiles is a key driver of profitability and sustainability. The modeling and analysis of a person’s digital records assist insurers to tailor their services, products and premiums to each customer’s specific situation.

Data analytics also can be used to retain high-value customers, employees and brokers by discerning those at risk of leaving. It can be further wielded to identify hidden revenue opportunities within the customer base.

Social media can be used to deepen customer knowledge, identify key life events and record customers’ preferences. Analyzing and modeling this source of data can reduce acquisition costs, enhance customer service and target customers more efficiently.

With the intensifying regulatory environment, stakeholders demand more information in real time. Analytics is an opportunity to implement real-time triggers to provide early detection of issues and automate compliance reporting to meet stakeholders’ needs.

Analytics can deliver more value when integrated with all facets of operations, including segmentation and market acquisition, risk-based pricing, underwriting, distribution strategy, customer experience, claims optimization, liabilities valuation and reporting. In a volatile global economy, analytics helps insurers identify new growth opportunities, improve market forecasts and optimize bottom-line results.

Significant investment in people, hardware, software and technology is required to develop strong analytical capabilities. Without the appropriate skills and tools, analytics will not achieve the expected return. Talent in segmentation, customer data and predictive modeling is emerging as the most in-demand skill set in the insurance sector. Finding these skill sets and getting senior management to support investments in analytics remain challenging.
Although these functions and risk reporting increase the cost of doing business, they also create the opportunity to improve operational risk management. An example is the Own Risk and Solvency Assessment (ORSA). Despite the amount of effort the rule entails, it provides incentive for insurers to improve risk management and make better use of their capital. ORSA should serve as a tool to enhance an insurer’s understanding of the interrelationships between its risk profile and capital needs.

The quality of a provider’s corporate governance practices also is important to maintain market assurance and the confidence of depositors and policyholders. In 2015, successful providers of life insurance and annuities in Canada will position to better identify significant risks, assess the potential impact, and implement policies and controls to effectively manage these threats.

Another compliance issue sure to be of concern in the future is International Financial Reporting Standards (IFRS) 4, Insurance Contracts. The International Accounting Standards Board (IASB) is expected to finalize IFRS 4 in 2015 and could require compliance by 2018 or 2019. This new standard will establish how insurance companies must value insurance contracts. While it will surely affect how companies report earnings, it may also have an impact on current life insurance options for consumers, compelling some providers to eliminate products with long-term guarantees.

In 2015, successful providers will begin examining the practical aspects of implementing IFRS 4, Insurance Contracts, determining how their products would perform under the new standard. These insurers will assess the economic impact of new revenue and profit patterns on their existing product portfolios to inform potential changes.

Many companies may not have the proper infrastructure in place to implement the new standard. Insurers will need to install new financial reporting systems, create more detailed actuarial models, develop newer methods of communicating their financial results and establish a new control environment. These are complex and costly undertakings.

On the asset side, the IASB recently published IFRS 9, Financial Instruments, creating new approaches for classifying assets and accounting for asset impairments. Companies will need to develop models that predict expected losses from these assets. This new standard, set to become effective on 1 January 2018, adds significant complexity to the financial reporting process.

Enhance data security

In the wake of numerous recent data breaches, cybersecurity has become a strategic issue for providers of life insurance and annuities in Canada. Like other industries, insurers are increasingly exposed to cyber thieves and vulnerable to corporate espionage caused by internal providers.

Proactively address the new regulatory regime

Regulators are demanding that companies enhance their compliance and control functions in 2015. In this regard, insurers must demonstrate that they have programs in place to ensure structured and disciplined governance of key risks and functions.

To address these requirements, providers of life insurance and annuities will seek to strengthen their organization structures, reporting lines and staffing levels within corporate functions. While companies in recent years have increased focus on finance and actuarial functions, they will accord additional attention to internal audit and compliance functions in 2015.

Insurers will need to install new financial reporting systems, create more detailed actuarial models, develop newer methods of communicating their financial results and establish a new control environment.
and external security breaches. Cyber criminals exploit enterprise weaknesses and corporate defenses to steal intellectual property and customers’ personally identifiable information, compromise corporate strategy, and pilfer or manipulate confidential and regulated information.

As the insurance industry further embraces the use of mobile and digital devices and new distribution channels, the risk and impact of cyber theft becomes more problematic. The new ways of developing and distributing products generally require new processes, systems, languages and cultures – all involving varying degrees of security risk and threat awareness. Security and privacy measures are needed to protect companies as they increasingly adopt digital technologies.

Unfortunately, few insurers in Canada have direct insight into their cyber liabilities involving digital assets. There is also a significant gap between the nature of new threats and the capabilities of companies to monitor, detect and thwart these attacks.

The integrity of electronic data is another key concern. Insurers need to independently show evidence of a data breach and determine its impact to distribute the liability. New methods are needed to definitively identify the cause of the data security incident, when it occurred, the assets affected, and whether insured assets were exposed outside the organization.

Increased regulatory oversight also has increased the need for enhanced data security. Data sovereignty issues have arisen for internationally active companies in Canada. While data may be stored on servers physically located in one country, customers may reside in a different jurisdiction with more stringent data security rules. In March 2014, The European Parliament overwhelmingly voted in favor of stronger data protection requirements for individuals, reinforcing the requirements for explicit permission to transfer certain types of personal data from one country to other countries. These new data transfer restrictions extend to subsidiaries and other parts of a company, thus affecting the insurer’s internal risk management.

Successful providers of life insurance and annuities in 2015 will transform and improve their existing security programs and invest in cutting-edge security software and systems.

Successful providers of life insurance and annuities in 2015 will transform and improve their existing security programs and invest in cutting-edge security software and systems. These insurers will incorporate the following practices:

- A pragmatic, risk-based information security strategy integrating solutions that address business needs, compliance requirements and enterprise risk management objectives
- Listening better to what is going on in the market, understanding information security trends and threats and adjusting their risk assessment accordingly
- Processes to continually reassess the threat landscape to confirm that new technologies address the right priorities.

Regulators and rating agencies now view cyber risk as a primary threat to solvency because of the significant, rapid and unexpected impact of a security incident and the inability of an insurer to effectively respond to the event. In all circumstances, companies remain accountable for the security of private records and data collected from customers.
Canadian property-casualty
Improving the level of consumer trust
Market summary

Current economic and marketplace developments in Canada suggest a continuation of the challenging and highly competitive property-casualty insurance conditions. Historic low interest rates, volatile investment returns and low gross domestic product (GDP) growth are forecasted to persist in 2015, adversely affecting the industry’s profit margins and premium growth. Many property-casualty insurers are also making significant investments in infrastructure that will further erode profit margins.

Regulatory and accounting changes continue to challenge insurers. These include the need to implement risk management processes and increased control functions organizationally. In 2014, Ontario passed legislation requiring reductions in automobile insurance rates further pressuring the bottom line.
At the same time, several large catastrophes have taken a financial toll on the country’s insurers. These run the gamut from severe flooding in Calgary and the Greater Toronto Area and ice storms in Ontario and Quebec, to increasingly harsh winters across the country and devastating tornadoes in Southwestern Ontario. Human-caused disasters include an explosion in Lac-Mégantic, Quebec, train derailments and oil pipeline ruptures.

Industry consolidation is occurring against this backdrop. In each of the past five years, the market has experienced at least one major transaction, the largest transaction in 2014 being Desjardins acquisition of State Farm’s Canadian operations. As of year-end 2014, the market share of the top five Canadian property-casualty insurers had increased to 45% of premium volume. As the difficult economic conditions continue in 2015, further consolidation is anticipated.

Along the insurance value chain, major transactions also were recorded between independent brokers and service providers. Not only are insurers getting bigger, so are the firms that deal with them.

In 2015, to achieve growth and relieve pressures on costs and profit margins, successful property-casualty insurers in Canada will need to undertake the following strategies:

- Improve customer connectivity
- Expand distribution and customer service
- Transform operations to meet future needs
- Build an enterprise data excellence infrastructure
- Proactively address regulatory changes
- Improve cybersecurity

Improve customer connectivity

Based on EY’s 2014 Global Insurance CFO Survey, the top three business drivers for insurers around the world over the next few years will be the need to achieve growth, relieve pressures on costs and margin to improve profits and respond to regulatory change (as shown in Figure 1). These goals are the focus of Canada’s property-casualty insurance market for 2015.

In this regard, a strategic imperative for insurers across all product classifications, geographies and operating models is the need to strengthen customer relationships, putting customers at the core of operations. Enhancing customer experience is a key priority in 2015 to ensure that customers are informed, connected and empowered by the variety of ways in which they can shop for insurance. Websites, blogs and social media need to assist customers with comparing insurers and their respective products and service. These tools increasingly must be mobile and accessible on a constant basis.

Studies indicate that customers consult 11 information sources on average before purchasing an insurance policy. This puts the competitive onus on insurers’ need to present a clear and differentiated brand image, in addition to transparent pricing terms, customer service, claims settlement, billing options, product offering and channel offering.

Customer expectations are much higher in 2015, largely influenced by experiences engaging with other industries. They want more personal interactions via digital channels and increasingly seek such options as web chat, video and mobile. Consumers further expect immediate access to their insurers through these multiple channels. Customers expect more customization, personalization and flexibility in their shopping experiences than ever before. Consequently, the availability of consistent information through multiple channels is a baseline requirement for insurers in 2015.

Since personal and digital customer experiences are influenced by these direct and indirect insurer interactions, the key challenge for insurers is to harness the power of digital to improve customer engagements while lowering costs. The goal in 2015 will be to develop flexible and integrated multi-channel capabilities, driving the right consumers to the right channels for the right interactions at the right price.

Consumers will compare their experiences with property-casualty insurers against other consumer industries, expecting comparable standards of service and rewards for loyalty. Due to the increased use of social media, even infrequent instances of negative sentiment can reach a broader audience and have a negative effect on an insurer’s reputation and brand.
Buyers are looking for the value of products to be clearly demonstrated via price, product features and service tailored to their needs. Successful insurers in 2015 will leverage customer-centric innovation to differentiate themselves and gain sustainable market leadership positions.

Expand distribution and customer service

With insurance consumers demanding enhanced transparency via multiple channels to shop and transact, optimizing distribution channels is a key challenge for many property-casualty insurers in 2015.

The goal is to create a consistent customer experience by integrating distribution and communication channels and providing enhanced transparency of information. The latter is critical as 56% of Canadian consumers trust their property-casualty insurance company, according to EY’s Global Consumer Insurance Survey 2014 (see figure 2). The industry’s trust level is lower than that of banks, online retailers, supermarkets, automotive manufacturers and pharmaceutical companies. These results also compare unfavorably to global and US results, as well as Canada’s life insurance industry results.

In 2015, many property-casualty insurers need to expand their distribution channel and communication channel mix to respond to evolving customer expectations and optimize their growth. The industry has the opportunity to achieve these goals through digital transformation. Top-performing insurance companies in 2015 will have stronger digital capabilities, refined metrics, upgraded tools, new skills and reoriented cultures.

Such technologies as cloud computing, smartphones and business collaboration software are changing the consumer landscape. Insurers must adopt these tools to deliver and receive digital information on any device – safely, securely and with fewer resources.

Figure 1: Primary business drivers

Question: Please rank in order the following business drivers facing your organization through 2020

Percent of respondents ranking the driver among the top three

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<th>Business Driver</th>
<th>First</th>
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<tbody>
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<td>Achieving growth, expanding into markets and/or expanding through M&amp;A activity</td>
<td>6%</td>
<td>17%</td>
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<tr>
<td>Relieving pressure on costs and margin and improving profit</td>
<td>26%</td>
<td>11%</td>
<td>17%</td>
<td>54%</td>
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<tr>
<td>Responding to regulatory change</td>
<td>11%</td>
<td>20%</td>
<td>20%</td>
<td>51%</td>
</tr>
<tr>
<td>Improving capital and liquidity position</td>
<td>17%</td>
<td>11%</td>
<td>3%</td>
<td>31%</td>
</tr>
<tr>
<td>Addressing competition from globalization and new market entrants</td>
<td>9%</td>
<td>11%</td>
<td>11%</td>
<td>31%</td>
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<tr>
<td>Establishing risk mitigation and management</td>
<td>20%</td>
<td>6%</td>
<td>3%</td>
<td>29%</td>
</tr>
<tr>
<td>Increasing simplification through organizational restructuring</td>
<td>3%</td>
<td>14%</td>
<td>17%</td>
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<tr>
<td>Preparing for leadership change and succession</td>
<td>9%</td>
<td>9%</td>
<td>18%</td>
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<tr>
<td>Other</td>
<td>3%</td>
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Order of priority:
- First
- Second
- Third
Initiatives to optimize operating models in other functional areas like sales and underwriting, billing and payments, are also expected in 2015.

Insurers further need to share information and create consistent experiences across multiple integrated channels. Omni-channel distribution optimizes the customer experience by considering client needs across the value chain. Ensuring that business models and operating models support an omni-channel approach in 2015 will help position insurers to optimize the customer experience, achieve competitive differentiation and accelerate growth.

Transform operations to meet future needs

A major focus for insurers in 2015 will be core operations improvement, given the potential to augment customer experience, improve operational agility, increase speed to market and accelerate growth.

Many insurers will take a comprehensive approach to improving core operations, such as policy administration (sales and operational underwriting), claims and billing, while also seeking to properly manage related risks.

At the same time, they will seek more discrete improvements. Partial gains can be achieved by focusing improvement efforts on one enabler at a time, rather than undertaking a large-scale transformation aimed at improving multiple enablers simultaneously.

On the claims front, for instance, the following initiatives in 2015 will prove beneficial:

- Implementation of systems to measure and reduce claims leakage
- Optimization of claims outcomes by ensuring appropriate amounts are paid claimants
- Claims strategic sourcing strategies to optimize loss adjustment expenses and indemnity costs
- Approaches that segment claims based on customer profile, claim type and complexity
- Claims fraud management
- Improved ease around mobile/internet claim filing

Initiatives to optimize operating models in other functional areas like sales and underwriting, billing and payments, are also expected in 2015.

Build an enterprise data excellence infrastructure

Analytics and big data offer potentially significant opportunities for property-casualty insurers in 2015. Companies now have access to massive volumes of structured and unstructured data, such as public information about customers’ lifestyles and online experiences.

Synthesizing this amount of data requires...
a new approach. Predictive analytics and modeling methods are powerful tools that can assist insurer growth, profitability and sustainability objectives.

Personal data is now a new economic asset class. The ability to identify customer behaviors and personal risk profiles has become a competitive differentiator, guiding the tailoring of services, products and premiums to each customer's specific situation. Data analytics also can be leveraged to develop strategies to retain high-value customers, employees and brokers, as well as to pinpoint hidden revenue opportunities within the customer base. Insurers can identify new growth opportunities while protecting and optimizing bottom-line results.

Analytics deliver more value when integrated to all facets of operations, including segmentation and market acquisition, risk-based pricing, customer lifetime value, underwriting, distribution strategy, customer experience and claims optimization.

To develop strong analytical capabilities that achieve anticipated returns, significant investments in people, hardware, software and technology are required. Not surprisingly, the most in-demand skill set in the insurance sector is talent with segmentation, customer data and predictive modeling capabilities.

Telematics and usage-based insurance pricing are other growing technology trends in the property-casualty market, as they are in other markets. In this regard, most top-tier Canadian insurers have shifted from a “wait-and-see” mindset to a more action-oriented approach. Early results indicate that consumers are increasingly ready to embrace usage-based insurance.

Proactively address regulatory changes

As the global financial crisis emphasized, many financial institutions had relied too heavily on the use of quantitative models, external ratings and industry benchmarks. As a result, regulators are requiring insurers to become more disciplined with regard to risk management, capital planning and operational oversight.

A major regulatory initiative is the Own Risk and Solvency Assessment (ORSA). ORSA requires insurers to implement and show evidence of robust risk identification, measurement and analysis, monitoring and reporting, and management oversight processes. The goal is to ensure that an insurer’s own assessment of its current and future solvency position is well understood and managed.

ORSA is not purely a regulatory compliance exercise. It can provide business value if considered as an integrated process that enables better decision-making by senior management and the board. A well-executed ORSA process should illuminate the risks an insurer faces, the robustness of its oversight, and the controls designed to manage risks.

In 2014, insurance companies were required to prepare their initial ORSA report. The ORSA process is expected to continuously evolve, and companies will be expected to further refine their approaches in 2015.

Although Canada’s Office of the Superintendent of Financial Institutions (OSFI) does not approve an insurer's ORSA, the ORSA guideline states that OSFI may request and review the assessment and supporting documentation. OSFI also has requested that the ORSA report to an insurer’s board of directors be subject to periodic reviews by a skilled, objective and experienced internal or external resource.

Regulators also now require that an insurer’s senior management and board of directors increase their oversight of the organization’s compliance and control functions. Many companies have addressed the new requirements by modifying their organizational structures and reporting lines, increasing corporate resources and improving guidance and documentation processes.
Unfortunately, few property-casualty insurers in Canada have direct insight into their cyber liabilities involving digital assets.

There is also a significant gap between the nature of the new threats and the capabilities of companies to monitor, detect and thwart these attacks.

The integrity of electronic data is another key concern. Insurers need to independently show evidence of a data breach and determine its impact to distribute the liability. New methods are needed to definitively identify the cause of a data security incident, when it occurred, the assets affected, and whether or not insured assets were exposed outside the organization.

Increased regulatory oversight also has increased the need for enhanced data security. Data sovereignty issues have arisen for internationally active companies in Canada. While data may be stored on servers physically located in one country, customers may reside in a different jurisdiction with more stringent data security rules. In March 2014, the European Parliament overwhelmingly voted in favor of stronger data protection requirements for individuals, reinforcing the requirements for explicit permission to transfer certain types of personal data from one country to other countries. These new data transfers restrictions extend to subsidiaries and other parts of a company, thus affecting the insurer’s internal risk management.

The accounting changes as set forth in the exposure drafts will fundamentally alter the presentation and measurement of insurance contracts. The impact on business processes and systems will be significant, requiring careful consideration and comprehensive programs to implement IFRS 4 Phase II alongside IFRS 9.

**Improve cybersecurity**

In the wake of numerous recent data breaches, cybersecurity has become a strategic issue for property-casualty insurers in Canada. Like other industries, insurers are increasingly exposed to cyber thieves and vulnerable to corporate espionage caused by internal and external security breaches. Cyber criminals exploit enterprise weaknesses and corporate defenses to steal intellectual property and customers’ personally identifiable information, compromise corporate strategy, and pilfer or manipulate confidential and regulated information.

As the insurance industry further embraces the use of mobile and digital devices and new distribution channels, the risk and impact of cyber theft becomes more problematic. The newer ways of developing and distributing products generally require new processes, systems, languages and cultures – all involving varying degrees of security risk and threat awareness. Security and privacy measures are needed to protect companies as they increasingly adopt digital technologies.

Successful property-casualty insurers in 2015 will increase their emphasis on their organization’s control functions, risk reporting and management, and proactively shape their discussions with regulators.

At the same time, insurers must address the evolving accounting environment, which entails the provision of more extensive, precise and detailed disclosures. In 2015, a property-casualty insurer must pay particular attention to these evolving International Financial Reporting Standards (IFRS) rule changes:

- IFRS 4 (Insurance Contracts)
- IFRS 9 (Financial Instruments – effective 1 January 2018)
- IFRS 15 (Revenue from contracts with customers – available for early adoption with mandatory adoption effective 1 January 2017)
Successful property-casualty insurers in 2015 will transform and improve their existing security programs and invest in cutting-edge security software and systems.

These insurers will incorporate the following practices:

- A pragmatic, risk-based information security strategy integrating solutions that address business needs, compliance requirements and enterprise risk management objectives
- Processes that better gauge what is going on in the market, understanding information security trends and threats and adjusting risk assessment accordingly
- Processes that continually reassess the threat landscape to confirm that new technologies are addressing the right priorities
- Executive and board support that leverages the expertise of partners and vendors to determine which security functions must remain on premises or be outsourced to cloud-based software providers
- Processes that assure that information security is an integral part of the risk management function rather than a stand-alone unit

Regulators and rating agencies now view cyber risk as a primary threat to solvency because of the significant, rapid and unexpected impact of a security incident and the inability of an insurer to effectively respond to the event. In all circumstances, companies remain accountable for the security of private records and data collected from customers.
Europe
Product innovation ahead
Market summary

The year ahead is set to be a challenging one for the European insurance industry, with slow growth and low interest rates affecting the trading environment. Successful insurers in 2015 will look to seize opportunities to maximize their digital channels and make better use of the data they capture in order to personalize products and services. Insurers have traditionally lagged behind the retail sector in product innovation; it usually occurs incrementally and is transaction-led.
Within general insurance in Europe, the widespread use of aggregators by customers, combined with low retention rates, means that there is continual pressure on margins. Insurers need to look at servicing customers more efficiently, finding new ways of encouraging loyalty and brand “stickiness,” and providing fresh services for evolving customer needs. The disintermediation of life and pensions has also put more pressure on insurers to maximize the direct channel.

One possible solution lies in improving the client interface. The key themes here are technology, data and analytics. In order to make more of client interaction, insurers must refresh legacy systems and provide customers with a range of digital communication channels, while making better use of customer data to tailor products and services to the individual.

Within personal lines, where products are increasingly commoditized (partly as a result of price-driven distribution via aggregator channels), there is an environment in which differentiation becomes more problematic. While the growth of telematics has led to some personalization, it has yet to reach its full potential, with most products aimed at young drivers. Insurers will invest in using telematics data in a more innovative way to appeal to the mass market.

Insurers will also seize the marketing opportunities offered by the connected car, giving customers supermarket vouchers for the store they most commonly visit, for instance. In addition, they will be looking at refreshing their finance functions. With Solvency II and International Financial Reporting Standards (IFRS) 4 Phase II putting additional demands on finance and actuarial departments, European CFOs will have to maintain a strong focus on meeting the various regulatory requirements.

Insurers face a juggling act to use these opportunities to personalize products, find other ways of adding value, build greater loyalty, and increase customer retention and profitability while responding to the various regulatory and tax challenges. Having a robust proactive and reactive strategy will enable insurers to remain competitive in 2015. By keeping their products simple and transparent, and investing in areas such as data, analytics and technology, European insurers will be in a better position to build a rapport with their customers and differentiate their offerings from the competition.

Macroeconomic Eurozone focus: slow growth and low interest rates dominate challenging trading environment

The recovery throughout Europe looks delicately balanced, with signs of a slow recovery on the consumer side overshadowed by low business investment rates and slower global growth. Critically, unemployment has stopped rising and the reduced threat of imminent job losses has significantly boosted consumer confidence. Real incomes are now rising, and there are tentative signs of an improvement in European housing markets and car sales. Against this, global growth appears to have slowed and sanctions against Russia have injected additional uncertainty. As a result, concerns about deflation have risen, prompting the European Central Bank (ECB) to introduce a range of measures designed to boost credit growth and extend their forward guidance.

Interest rates now look set to be lower for even longer, further increasing the pressure on life companies to reconcile investment guarantees with low yields. Insurers are therefore likely to be under continuing pressure to adapt their business models to this new paradigm of ultra-low interest rates and a steady regulatory treadmill.

The pressure on margins has prompted life insurers to move into more risk-based products on the liability side and, in some cases, asset-backed securities on the investment side. However, in 2015, the ECB will be a significant purchaser of senior tranches of these products, reducing supply and potentially leaving life insurers exploring alternative assets that offer attractive returns with an acceptable risk profile and capital charge.

Outside of Europe, the end of quantitative easing is likely to produce a year of significant financial market volatility in equity, fixed income and emerging market products. The key challenge for the life sector is, therefore, to balance the search for yield without taking on unwarranted risk and being caught out by the increase in market volatility.

Life insurers will have to intensify their efforts to make in-force business more
Although the Bank of England is likely to start raising interest rates in the early part of 2015, any upward movement in borrowing costs is set to be a slow and gradual process. So insurers’ business models will continue to be challenged by a low rate environment. In this respect, the Bank of England has made clear that the risks around insurers investing in less traditional assets in a hunt for yield are firmly on their radar.

The bank has also warned that regulators will take a tough stance against UK insurers that seek to play down risks in an attempt to reduce the amount of capital they hold under Solvency II. So, to avoid a jump in capital requirements, insurance companies will have to tread carefully in presenting their risk models in the run-up to Solvency II’s implementation on 1 January 2016.

The UK economy is set to enjoy a robust expansion in 2015, with economic growth outstripping that in the Eurozone for the fifth successive year. Unemployment should continue to drop, aided by modest growth in wage costs. But subdued rises in pay packets will constrain growth in nominal personal disposable income and see consumers’ appetite to spend cooling down slightly.

General insurers should continue to benefit from a buoyant housing market and corresponding demand for “big-ticket” items. That said, growth in home and motor insurance premiums will remain squeezed, in part because of regulatory changes (the decision by the Competition and Markets Authority to ban exclusive pricing deals between motor insurers and price comparison websites being a recent example). But the rollout of telematics and action to tackle fraudulent claims means that general insurers’ costs should also be cushioned.

Meanwhile, tax reforms will add to an already tough environment for the UK life sector. For example, the current 55% tax rate on pension savings passed on in the event of death will be abolished from April 2015, making annuities more unattractive to retirees. So annuity providers, already suffering from the scrapping of compulsory annuities in the March 2014 Budget reforms, face extra pain.

Admittedly, the further broadening of pensions auto-enrollment to small and micro employers from April 2015 will be a positive for pension providers. But a cap of 0.75% on charges for these schemes will squeeze providers’ margins.

Macroeconomic UK focus: economic expansion continues, but regulatory and taxation changes will continue to present a challenge

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What will be on the mind of insurers in Europe during 2015?

- Walking a tightrope: navigating market volatility
- Building trust: becoming more customer-centric
- Digital consumer: opportunities and challenge
- Joining the dots: using data in a more connected way
- Regulation: from Solvency II to consumer protection
- Change is the only constant: time for a finance refresh
- Tax: insurers embrace for shifting landscape

Walking a tightrope: navigating market volatility

European insurers will continue to be challenged on both sides of the balance sheet in 2015. Excess capacity and high levels of competition are reducing margins overall. In markets such as the UK and the Netherlands, this has been further exacerbated by the continued rise of aggregator websites, allowing customers to shop around for the best deals in home, travel, motor and other classes of retail insurance.

The result is heightened levels of competition in many classes of business; dynamics that are expected to continue into 2015. According to broker Aon Benfield, even a US$100b insurance loss from a catastrophe event could be insufficient to disrupt the market and halt the softening trend in non-life (re)insurance, particularly as capital can more easily flow into the industry postevent now than in the past, as we discuss later in this publication.

There are obvious benefits to being a composite insurer in the new environment. Insurers are able to decrease the amount of capital they are required to hold by diversifying their liabilities across different lines of business and geographies (with Solvency II offering a diversification credit). However, it is worth noting that the same effect cannot be achieved by an investor that diversifies its portfolio via a series of investments into monoliners or domestic players. There is a premium to such diversification under Solvency II. While, traditionally, life insurers were able to boost their assets using the equity markets to create additional performance, over the last few years, the level of safety on offer from the equity markets has decreased significantly, with high levels of volatility from quarter to quarter and day to day. The big danger is a short-term but large-scale increase in interest rates. Some providers are hedging against this eventuality, while others are altering their portfolio of products to reduce the risk of write-offs in bond portfolios.

The prolonged low interest rate environment will continue to challenge European life insurers in 2015, reducing their investment income and squeezing product margins. Guaranteed liabilities pose a particular threat, as subdued earnings may be too small to meet long-term obligations.

With multibillions of euros worth of in-force contracts putting balance sheets under stress, the providers that will successfully navigate this environment will overhaul their business models. In some countries this takes place by placing a greater emphasis on selling and marketing unit-linked products; in some other countries there is more attention for pension products with defined contribution features. While the types of product vary from country to country, most offer an insurance and regulatory tax wrapper around asset management tools, allowing more risk to be transferred to policyholders.

Another option for insurers is to find a new balance between biometric risks such as health, long-term care and disability and their mortality exposure. By taking an innovative approach to service and cost it is possible to generate an appropriate margin. Some health insurers for instance, are offering incentives to policyholders who share health and fitness information via apps and wearable devices.

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Non-life reinsurers adapt to a growing capital market presence

The influx of capital into the property catastrophe reinsurance industry from pension funds and other institutional investors has gained pace over the past five years. In the low interest rate environment, investors have grown their allocations to the insurance sector as an alternative asset class, drawn by the non-correlating nature of insurance investments and reasonable returns on offer.

This trend has exerted downward pressure on reinsurance pricing and displaced capacity from traditional providers into other classes of business. Reinsurance broker Guy Carpenter estimates that alternative capacity now accounts for roughly US$50b, or 15% of the global property catastrophe limit.²

For European providers, the alternative capacity – particularly for property catastrophe classes of business – will heighten levels of competition and force traditional players to adapt their business models. While pension allocations to insurance-linked securities remain relatively low, typically around 1% of total funds, appetite for insurance appears to be long-term in nature.

Building trust: becoming more customer-centric

Levels of trust in the insurance sector are, at present, among the lowest in any consumer industry. This is intrinsically linked with low levels of customer retention and changing distribution patterns, particularly with the rise of the aggregators in many European countries. The financial crisis further dampened consumer support for financial services in general, while additional tainting from scandals, such as payment protection insurance mis-selling, has also left its mark.

Findings from EY’s Global Insurance Consumer Survey 2014 tell us that there are ever-reducing “touchpoints” between insurer and customer in today’s environment. While the annual renewal cycle offers more opportunities in non-life to communicate with customers, these are not being fully exploited in the digital channels increasingly used by consumers. Many insurers leave relationship management to the intermediary, missing out on opportunities for greater dialogue with customers.

The ability to foster loyalty and build relationships with customers in life and pensions is even more of a challenge. There may be little communication with the insured for many years after a policy is taken out.

The aftermath of the retail distribution review (RDR) in the UK, and the Dutch equivalent, is leaving behind an “advice gap” in both cases. This is forcing life insurers and pension providers to consider other routes to market beyond the investment advisor or broker channel.

Insurance companies will seize this opportunity to become more customer-centric.

Our research suggests customers are receptive to having greater contact with their insurers. Even within retail insurance, where customers are more likely to shop around, levels of brand loyalty remain high even after they have switched to another provider.

Insurers have a strong foundation on which to base their growth from here, but they will need to evolve their customer engagement approach. The contact that customers’ desire needs to be made more personalized, relevant and timely. Some insurers have begun this journey by using telematics to deliver robust pricing strategies that reward customers for things such as their good driving habits or healthy lifestyle choices, but many more options could be explored to use customer data to tailor and create bespoke products to suit specific needs at specific touchpoints.

As an example, customers may not always want the most comprehensive cover available: at certain life stages, they may prefer a cheaper product with reduced coverage that better suits their financial needs. Offering a Ferrari every time is not always what people want. The more the customer feels the contact they receive is relevant and fits with their personal needs, the more they will want to hear from their insurer and keep them front of mind.

Creating a two-way dialogue that works for both parties is key to building the customer loyalty that will lead to higher customer retention rates.

Making more of the shop window

Claims are the shop window by which the insurance industry is typically judged, and it is during the big events – typically catastrophe events – that the industry’s role and profile generates widespread attention. The Central European floods in 2013 caused economic losses of US$16.5b across Germany, the Czech Republic, Hungary and Poland, and insurers paid out on claims worth US$4.1b (according to Swiss Re Sigma).³

What was missing was a more coordinated and visible response from the industry, both in its approach to handling claims from the floods and in contributing in more practical ways to the wider relief efforts. Being more actively involved in coordinating post-disaster responses following future European events should boost the industry’s reputation in the eyes of the public.

A more proactive approach to big loss events underlines the industry’s role in building more resilient communities. At the International Insurance Society Conference in June 2014 in London, Britain’s Prince Charles encouraged the insurance industry to develop its ClimateWise program to tackle disaster preparedness and climate change.

Digital consumer: opportunities and challenge

There is a constant drive for insurers to understand, communicate with, service and retain customers better. Yet there are many challenges in doing so, not least of which is the advice gap mentioned before, which, created by the RDR, is forcing life and pension providers to go direct to their customers.

It is also becoming a more complicated environment for customers to make decisions about financial products, with no fixed retirement age, people living longer and the scrapping of compulsory annuities in the UK. There is a greater responsibility on insurance companies to communicate with the customer, provide information and tailor products to their needs.

In most European countries, the channels to reach the customer are becoming more digital, particularly with the expanding use of mobile devices. One industry analysis predicts that digital interactions with financial services organizations will outnumber face-to-face by 250 to 1 by 2016 and mobile interactions will outnumber calls by 30 to 1. In order to maximize on this shift, insurers must first tackle their digital deficit.

This is a challenge in an era of inflexible and aging legacy systems. The typical policy administration system is 15 to 20 years old, and they are getting in the way of doing business, rather than acting as an enabler. Migrating to new systems with modern user interfaces is one solution, but a costly one that brings with it significant migration risks.

Instead, an increasing number of insurers are using robotics to bring together disparate legacy systems. Robotic process automation (RPA) is a cost-effective and flexible solution for extracting, compiling and processing information held across multiple systems, as well as updating them with new policy information.

Another important trend within financial services is the use of digital passports and personal data stores (PDS), with the UK and other European governments providing a single digital identity that can be used across any government product or service. But, importantly, this digital identity and passport can also be used across financial services. In this model, the customer uses the same logon and identity across any company, owns their own personal data, constantly enriches this and can simply share it with insurers – so no more time-consuming form filling or providing proof of identity. Encouraging customers to use PDS means that insurers will get more up-to-date information – with the potential for far more information than traditional approaches – and hence has far better customer understanding and chance of matching products to customer needs, to form the basis of truly trusted relationships.

Joining the dots: using data in a more connected way

Key findings in EY’s new global financial services data analytics report The science of winning in financial services state that many firms agree that data is their most valuable strategic asset and a holistic approach to data is crucial for success; it’s not just a technology problem. Many insurers within Europe are only beginning to tap the immense potential that the data captured by the business has to offer. The sheer breadth of data on offer to insurers, internal and external, structured and unstructured, is one way providers will seek to differentiate and gain a competitive advantage.

Early on in the data and analytics journey, the enthusiasm to get going is (within some businesses) leading to the rapid expansion of analytics activities. But this is without due consideration of a suitable strategy to support business goals. With so much customer information already being captured, the upgrading of legacy systems is essential in order to analyze individual risks better and tailor products to customers.

A growing number of insurers are scaling up their analytical capabilities and, as a result, will be in a better position to use data in a more connected way. Meaningful insights can be drawn through more efficient use of data at virtually every stage of the insurance life cycle, from customer targeting to product design and pricing, underwriting, claims and reporting, but also through creating new associated services, giving opportunities for more touchpoints (disease prevention via wearable devices and wellness programs, for instance).

Within the mass market retail space, big data – such as credit checking and motoring conviction verification – is also being used to provide supplemental rating factors. There is a clear desire to gain more consistency in terms of how risks are priced in real time; a journey that will lead toward more external data being sourced.
2015 Global insurance outlook

Directive (IMD2), the Packaged Retail Investment Products (PRIPS) initiative and the second Market in Financial Instruments Directive (MiFID2), all of which must be complied with by 2017.

IMD2, which is currently the subject of trilogue discussion between the European Commission, European Parliament and European Council, provides local regulators with the option of banning commission payments. It also includes specific requirements on product oversight and governance, and is therefore likely to create significant changes to product and sales procedures and controls going forward.

Taken as a whole, these European regulatory initiatives require greater transparency in terms of the information provided to customers, revisions to relationships with distributors, and greater governance and oversight over new and existing products. Change plans should be developed and started during 2015 to ensure that the early 2017 deadline can be achieved and appropriate market strategies can be executed to maintain, or gain, market share.

Meanwhile, for many, the Solvency II programs that they had in place during huge untapped source of value for many insurers, given that around 70% of the premiums charged can go toward paying claims.

Cross-industry collaborations to combat fraud have resulted in much greater levels of cooperation and data sharing. As a result, fraud identification — both on the claims and application side — has improved and is often real-time enabled. Insurers are clearly alert to the opportunities, but more investment is needed.

Insurers looking to gain a competitive edge in 2015 will use this data to offer individuals more bespoke products. Telematics is a good example as, to date, most of the products are geared toward young drivers, whereas research suggests the wider mass market would be receptive to such offerings if suitably tailored to the customer. The challenge for insurers is to differentiate their offerings from what is already available and to come up with products that customers want to buy at key points in the life cycle.

Regulation: from Solvency II to consumer protection

While Solvency II remains a challenge for insurers until 2016 in terms of implementation, the regulators’ focus will shift in 2015 as consumer protection increases in importance. Insurers will need to plan for, and begin to make, operational, and potentially strategic, changes in response to the second Insurance Mediation Directive (IMD2), the Packaged Retail Investment Products (PRIPS) initiative and the second Market in Financial Instruments Directive (MiFID2), all of which must be complied with by 2017.

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Taken as a whole, these European regulatory initiatives require greater transparency in terms of the information provided to customers, revisions to relationships with distributors, and greater governance and oversight over new and existing products. During 2015, insurers will need to assess the impact of these initiatives on their governance, control and risk frameworks, sales processes and customer operations, and the IT and people that support them.

They should also consider the strategic impact of these changes on distributor relationships and product pricing. Change plans should be developed and started during 2015 to ensure that the early 2017 deadline can be achieved and appropriate market strategies can be executed to maintain, or gain, market share.

Cross-industry collaborations to combat fraud have resulted in much greater levels of cooperation and data sharing.

This raises a challenge in its own right: the more data that can be used to differentiate individual customers from each other, the greater the risk that some customers’ premiums become unaffordable, as their personal risk is so high. While that might be the right answer from an insurer’s perspective, and an effective use of data, there will be increased focus on the question of customer protection and maintaining insurance at a price that the customer can afford.

Preventing claims leakage is another big area for insurers, particularly in personal lines. Here, better analytics could be put to work, optimizing claims processes and identifying suspected fraud. This is a
2013 have been re-energized, as efforts have been made to complete their model development and associated validation to support their applications for internal model approval. Capital optimization is also receiving a new focus as firms look to change the composition of their balance sheets. While not all firms are going for internal model approval, they are all subject to the governance requirements set out under the directive and have to complete and submit to their regulator(s) a Forward Looking Assessment of Own Risks (FLAOR) or Own Risk and Solvency Assessment (ORSA) during 2014 and 2015 as preparation for Solvency II.

This has led many to re-evaluate their business processes to see how the forward-looking assessment is integrated into decision-making, ensuring activities such as business planning and stress and scenario testing are aligned to what is required under Solvency II. Inevitably, gaps have been identified, and firms are considering how to ensure their governance structures are robust and their ORSA processes are effective.

Change is the only constant: time for a finance refresh

The pressure on insurers’ finance functions is unlikely to abate in 2015, with Solvency II and IFRS 4 Phase II putting additional demands on finance and actuarial departments. Change is the only constant, and today’s financial and actuarial staff will need to demonstrate they can be effective change specialists – now an inherent part of the job.

Finance is increasingly being called upon to adapt to new reporting requirements; in particular, as companies carry out dry runs ahead of Solvency II coming into force on 1 January 2016. With so many pressures and the need to get priority projects over the line, European CFOs are maintaining a strong focus on meeting the various regulatory requirements.

The requirements under Pillar 3 of Solvency II are now clear. The regulator’s approach in the transition period until 1 January 2016 differs in each country regarding Solvency II. For example, in Belgium and the UK, there are requirements to involve auditors. However, in the Netherlands, this is not the case. Companies are seeking to ensure that transitional reporting is reliable and that disclosures are clear and of high quality, recognizing that the audiences of these documents will be looking carefully at them for the first time.

If they have not already done so, insurers will need to refresh their systems in order
As insurers are typically not able to recover their VAT costs, this additional amount would give rise to a significant “above the line” cost.

As part of the continued global pressure on tax avoidance and following the success of the Foreign Account Tax Compliance Act (FATCA), over 40 jurisdictions have volunteered to be early adopters of the OECD-published Common Reporting Standard (CRS). Early adopting jurisdictions are required to be CRS compliant by 1 January 2016.

Crucially for the insurance industry, there is no “back book” exemption for policies sold on or before 1 January 2016. In addition, there is no de minimis threshold, which would exempt low-value accounts held by individuals. The expected cost and effort required in reaching compliance is estimated to be in excess of £100m across the industry, with additional requirements to update IT systems.

For many insurers, there are also tax and other implications around globally mobilizing employees that will come under the microscope in 2015. International mobility is changing and seems to be moving away from long-term expatriate assignments to short-term business travel. This is an increasing area of focus for tax authorities, so insurers should act now to understand their exposure to the potential regulatory, immigration and customs risks.
Latin America

Expanding complexity in maturing and developing markets
Market summary

The Latin America insurance outlook for 2015 is generally favorable, with risks and opportunities becoming more complex based on market and country-specific conditions. Market demand, for example, is evolving at different rates due to different economic drivers across the region. On the other hand, competition is increasing, driven by the accelerating influence of large multinational and global participants. While regulation is moving toward more mature market standards, the demands of the increasingly technology-driven marketplace are challenging legacy channel product distribution.

In this complex environment, high single-digit nominal premium growth continues across the region. Although real economic growth recently slowed in two of the largest markets (Brazil and Mexico), stronger economic growth in other markets (combined with inflation in some areas) is generating overall premium growth in Latin America.
External forces in 2015

<table>
<thead>
<tr>
<th>Competitive conditions</th>
<th>Customer expectations</th>
<th>Capital adequacy regulation</th>
<th>Catastrophes</th>
<th>Technology changes</th>
<th>Analytics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prices softening, while service demands increase</td>
<td>Increasing consumer demands and business sector sophistication</td>
<td>Movement toward Solvency II and complex risk-based capital analyses</td>
<td>Recently benign CAT environment</td>
<td>Legacy systems inadequate to serve competitive marketplace</td>
<td>Capabilities are currently limited but increasing in importance</td>
</tr>
</tbody>
</table>

Other positive factors affecting the demand for insurance products include the long-term trend of reduced poverty, shrinking unemployment rates and population growth above the pace of most mature markets. Growing consumer acceptance of the need for insurance products also is spurring premium growth.

Prospects are most promising for the sale of life insurance products, given low penetration rates in the growing middle-market consumer segment. The relatively young populations across the region add to the long-term growth prospects of selling both life insurance and retirement products.

The expansion of the consumer classes similarly benefits the general insurance sector. For example, the rise in the ownership of automobiles bodes well for the sale of automobile insurance. Insurance policies associated with product sales, such as mobile technology warranties and theft protection, are another diversified growth opportunity. The need to insure catastrophic risks from floods, hurricanes and earthquakes is also generating premium growth in several Latin American countries. Nevertheless, as global insurers quickly establish a presence in these markets, competition has increased.

Commercial insurance markets across the region are maturing. Latin America’s economic growth and the reduction of trade barriers are of particular benefit to multinational corporations, also known as multilatinas. As these businesses grow, they find a need to focus on more sophisticated risk management. This has spurred an interest in captives, non-traditional risk financing and risk management, which, in turn, benefits commercial insurers and brokers with technical expertise in these solutions.

These varied growth opportunities are challenged by legacy distribution models, particularly in the lines of business where brokers retain control, such as the retail and commercial insurance markets. This may impede insurer expansion into broader consumer and smaller business sectors. Legacy distribution models generally are not perceived as an effective channel to reach the uninsured or adapt to changing customer demands, where some of the greatest opportunities for growth may reside.

More efficient distribution systems are needed to deepen insurer penetration of both life and general insurance markets in Latin America. Insurance consumers are developing communication preferences similar to customers in mature markets. For instance, they are expanding their use of internet and mobile communications, and increasingly expect their retail and service interactions to occur via multiple communication channels.

As the insurance markets mature, consumers will demand greater efficiency and quality of services. To address this issue, insurers must pursue economies of scale and build more robust technology.
infrastructures. Global insurers and larger regional insurers with the capacity to compete with scale and technology are already in the thick of this transformation. Latin America’s strong economic growth and recent regulation reforms have attracted several global insurers, reinsurers and insurance brokers, which are building their positions through mergers and acquisitions. At the same time, several Latin American-based insurers are engaging in cross-regional activities to bolster market share.

The insurance regulatory environment across the region is in harmony with mature markets at different speeds. Mexico is at the forefront, with Solvency II standards scheduled for implementation in 2015. Each country is on its own path and timetable to adopt a risk- and economic-value-based solvency structure. The development of trading blocs to liberalize trade, such as the Pacific Alliance, is hastening the pace toward broad global standards, including financial industry regulation.

The challenge for insurers in 2015 is to develop strategic initiatives that address the region’s expanding complexity. In 2015, successful insurers will do the following:

- Invest in efficient distribution alternatives and engage low-penetration markets
- Develop products to expand market reach and acceptance
- Transform operational platforms to increase quality of service for the consumer markets
- Respond to more sophisticated Latin American business clients
- Leverage advanced risk management solutions to comply with evolving capital solvency regulations
- Develop effective analytic advantage

Invest in efficient distribution alternatives and engage low-penetration markets

Weak insurance penetration of Latin American consumer markets has been a challenge for insurers. Distribution inefficiencies and related costs have contributed to the low penetration rate for both life insurance and personal lines products. These costs can represent a substantial portion of the total price, especially when attached to lower premium products targeting middle-tier consumer groups.

Insurers leveraging traditional channels across the region have enjoyed strong growth. However, now is the time to explore the use of alternative channels, while enhancing traditional distribution systems to more broadly address the customer base. This need is particularly pronounced for lower-penetration life insurance products; as such, products are noncompulsory, i.e., sold rather than bought.

Distribution inefficiencies are a problem in the general insurance sector as well. Among the concerns over established distribution channels are that their cost is keeping insurance price points above the consumer’s acceptance of value. Another issue involves insurance access and communication, which may not be developing parallel to consumers’ mobile/digital shopping and buying behaviors. Finally, more established insurer-distribution relationships are seen as possibly hindering the development of new products that require a different distribution approach.

Successful insurers in 2015 will increase market penetration by reaching out to consumers underserved by traditional distribution channels such as brokers and banks.
consumers to assist in their decision making. Consumers will be reached through public records, social media environments and workplace information sources. Messaging will be personalized and match the needs of consumers with specific service and product offerings. To develop products valued by consumers and businesses, successful insurers will promote a customer-centric business culture internally.

Many consumers in Latin America increasingly use mobile media to shop and buy numerous products online. In this regard, they have a greater desire to use online research prior to making a purchase, according to EY’s 2014 Global Consumer Insurance Survey. At the same time, they increasingly value personal interaction. Innovative insurers thus will develop mobile and social media strategies that present easy-to-understand products that reinforce their brands, and provide supporting digital information resources as a substitute for substantial personal interactions.

To initiate and enhance their personal interactions with consumers, successful insurers will increase their focus on affinity group associations in 2015. The workplace continues to be a trusted source of product endorsement in Latin America. Life insurers, in particular, have a great opportunity to tap into a youthful population in the workplace to offer products this demographic now needs, creating the potential for long-term growth. At the same time, the aging populations across Latin America present viable prospects for retirement-focused products. In Brazil, Mexico and Colombia, 16%, 14% and 15%, respectively, of the population is over 55 years of age. This compares to 25% in the United States. Longevity also is rising throughout the region. For Brazilians born in 1980, for instance, life expectancy was 63 years of age. A newborn today can expect to live to the age of 74 years. In Mexico, life expectancy has increased from 67 years to 77 years since 1980 and, in Colombia, from 65 years to 74 years.

For insurers in the region selling general insurance products to consumers, emerging distribution concepts involving kiosks and partnerships with traditional retailers will be tested in 2015. The goal is to offer simpler products to a broader base of consumers more efficiently.

Develop products to expand market reach and acceptance

Insurers in Latin America need to work more closely with legislators and regulators in 2015 to develop a more robust framework for the sale of insurance products with long-term value.

In recent years, compulsory insurance requirements and the expanding business and consumer classes have helped support the growth of general insurance sectors. Compulsory insurance requirements vary across Latin America, although workers’ compensation insurance and automobile liability/accident insurance are ubiquitous. The compulsory mandates have spurred increases in general insurance premiums in economies that are growing and have a rising percentage of automobile owners.

Nevertheless, the emerging consumer classes generally have not purchased insurance products voluntarily. A case in point is the Brazilian automobile insurance market. Despite the growth in its economy and middle class, insurance penetration has lagged. Brazil’s economy increased 44% in constant prices from 2003 to 2013, and the number of automobiles on the road doubled over this period. Yet, only 40% of automobile owners and 8% of residences are insured, according to various estimates. From 2003 to 2013, automobile insurance penetration barely nudged – from 0.6% of GDP to 0.7%. The import is clear: consumers remain reluctant to buy insurance beyond compulsory requirements.

Both life and personal lines insurers can achieve sustained growth by focusing their sales and marketing efforts on emerging consumer classes. Developing products with demonstrable value to these underserved customers is critical. Insurers also need to identify and leverage changes in customers’ life events. Marriage and the birth of children, for instance, present significant cross-sell and up-sell opportunities as well. In this regard, insurers must leverage sophisticated data management and advanced analytics.

For life insurance and pension products, surveys indicate that workers across Latin America are concerned over the adequacy of their savings, now that economic growth
Commercial insurers in Latin America will seek to deliver more complex risk solutions to corporate clients in 2015. Businesses across the region are enhancing their approach to risk and capital management, and want more cost-efficient solutions.

Many global brokers have invested capital and other resources to both sharpen their expertise and extend their geographic reach to support these complex risk solutions, which include captives, non-traditional risk financing and risk management. Many global brokers in Latin America also continue to expand their presence. In 2014, Jardine Lloyd Thompson Group P.L.C., London, acquired 75% of Rio de Janeiro-based SCK. Aon Risk Solutions expanded in Peru by acquiring Lima-based Graña y Asociados. The same year, London-based Howden Broking Group expanded its operations to Colombia by acquiring insurance brokers Proseguros and Wacolda.

is slowing while average life expectancies rise. In Brazil, where the National Institute of Social Insurance (INSS) provides retirement benefits for all private sector employees, most employers offer voluntary payroll deduction for supplemental plans, helping employees to maintain financial discipline to achieve their savings goals. Successful product development must respond to these needs in an easy to understand and access format.

Transform operational platforms to increase quality of service for the consumer markets

Competition is intensifying in Latin America due to the increase in the number of global insurers, and even indigenous insurers. To succeed in this environment, insurers must find efficiencies of scale and improve technology resources. The latter also is important, as consumers experiencing technology-supported mobile services in other industries, such as retail, increasingly expect similar services from insurers.

Pressured by the competitive conditions, and beset by legacy systems, insurers must reevaluate the effectiveness of their consumer market distribution and service. Consumers in Latin America seek more sophisticated insurance market experiences and real-time service, support and delivery.

Legacy systems are inadequate to support robust sales and customer service. Back office and process transformation across the enterprise must align the organization with critical consumer touchpoints, such as sales, payment, product delivery and claims processing. More flexible systems and processes are needed to incorporate innovative pricing and database structures, as well as online delivery.

Another important type of technology is telematics, which can shed light on consumer driving habits and vehicle use for insurance purposes. The industry appears to be developing this capability in Latin America, albeit no insurer has announced a program as yet. A potential hindrance may be the cost of installing monitoring devices into vehicles. Nevertheless, new vehicles in some countries may be required by law to include the devices. In Brazil, for instance, possible regulations include expanding current “track-and-trace” technologies to recover stolen new cars and trucks. Implementation of the law, Contran 245, has been delayed until 2016.

Successful insurers in 2015 technology will further streamline core underwriting, policy administration, delivery models and claims services. This technological retooling is essential to move from legacy one-off product-centric systems to flexible, customer centric core platforms, which address the region’s growing market maturity.

Respond to more sophisticated Latin American business clients

Commercial insurers in Latin America will seek to deliver more complex risk solutions to corporate clients in 2015. Businesses across the region are enhancing their approach to risk and capital management, and want more cost-efficient solutions.

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As global insurers continue to import expertise in sophisticated risk management and financial management from other geographic regions, the onus is on larger indigenous insurers to develop more sophisticated products responding to the complex risk needs of clients and intermediaries. As insurance buyer sophistication increases, less capable insurers are relinquishing these markets to global insurers with extensive technical expertise and infrastructure.

To support the development of more complex risk management solutions, regulators must become well versed in these alternatives. The captive market, for instance, has not developed to any significant degree in Latin America, partly because of complex and restrictive regulations and limited knowledge of captives. Many countries in Latin America also impose a withholding tax on cross-border premiums. As regulatory reforms begin to ease, these captive restrictions and new cross-country trade agreements permit their functioning. Several large Latin American corporations that have expressed interest in captive ownership may take this route.

Successful insurers, reinsurers and brokers in 2015 will develop enhanced efficiencies and technical capabilities to serve the emerging large account and middle markets. Certainly, the commercial insurers and brokers that possess the requisite technical expertise in these solutions are best positioned to lead large account and alternative markets.

**Leverage advanced risk management solutions to comply with evolving capital solvency regulations**

Political risks and regulatory changes are creating severe business challenges in some countries in Latin America. Successful insurers and brokers in 2015 will address these problems by exploiting the advantageous reforms across the region, continuously monitoring and evaluating political and regulatory developments, and engaging governments and regulators in meaningful dialogue.

The growing volume and complexity of insurance regulation anticipated in Latin America requires insurers in 2015 to be equipped with more flexible technology, data analytics and management talent. As to the last, insurers need talent that is well versed in regulatory and reporting matters to respond to increased regulatory information requests.

Current and future regulatory demands from multiple and potentially conflicting jurisdictions insist that insurers implement enterprise-wide solutions. Insurers need to integrate risk management with product development and actuarial resources. To do this, they must build solid risk management structures that prioritize data quality and data governance. Leading insurers will leverage technology to analyze risk within market segments to rapidly identify emerging trends.

Investment in advanced technology is critical in managing the increasingly complex, systemic risks across the region. Investing in efficient use of data analytics to satisfy these demands will be more cost-effective if accompanied by judicious staff additions.

**Develop effective analytic advantage**

As insurers expand throughout the region to seize growth opportunities in the maturing and developing markets, the increasingly competitive conditions will pressure margins and challenge operational functions. In this environment, successful insurers in 2015 will leverage technology and data analytics to more effectively underwrite and manage risk.
While data availability is more limited in the region than in more mature markets, the integration of technology into the lives of consumers and businesses is creating opportunities to leverage powerful analytics to identify new growth prospects, driving operational and marketing efficiencies, and serving markets profitably. Before leveraging advanced analytics, insurers must develop infrastructures that support the increasing granularity of claims and market data. Unlike other markets, insurers in Latin America have substantially less available external and internal data to employ predictive analytics.

The need to more efficiently tackle administrative expenses is leading some insurers to implement shared services strategies, outsource non-core activities and develop new technology platforms that better support customer markets. Closer relationships with key stakeholders such as distribution partners, service suppliers and data managers is becoming more essential.

Sophisticated analytics can turn even limited data into actionable knowledge, enhancing claims processing and underwriting accuracy. The focus in 2015 will be on enterprise-wide development and use of big data. New methods to query unstructured data present distinct opportunities in insurance marketing and underwriting. The growing use of social media in Latin America can also support the access and analysis of external consumer information for the same purposes. Social media analysis firms use text analytics technology to convert unstructured social networking data into structured formats. Data-mining tools can identify correlations between social signals and consumer behaviors.

Successful insurers in 2015 will be those that tap the power of big data to make more insightful and confident business decision making in product design, distribution, marketing, underwriting and claims. Insurers that take an holistic approach in developing their analytic capabilities will enjoy a competitive advantage, managing capital efficiently, while achieving sustainable margins.

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturing</td>
<td>Brazil</td>
<td>0.3%</td>
<td>0.3%</td>
<td>6.3%</td>
<td>5.8%</td>
<td>2.28</td>
<td>2.75</td>
</tr>
<tr>
<td></td>
<td>Chile</td>
<td>2.0%</td>
<td>3.3%</td>
<td>4.4%</td>
<td>3.2%</td>
<td>556.53</td>
<td>562.00</td>
</tr>
<tr>
<td></td>
<td>Mexico</td>
<td>2.4%</td>
<td>3.5%</td>
<td>3.9%</td>
<td>3.6%</td>
<td>13.24</td>
<td>13.42</td>
</tr>
<tr>
<td>Developing</td>
<td>Argentina</td>
<td>-1.7%</td>
<td>-1.5%</td>
<td>N/A*</td>
<td>N/A*</td>
<td>8.23</td>
<td>11.20</td>
</tr>
<tr>
<td></td>
<td>Colombia</td>
<td>4.8%</td>
<td>4.5%</td>
<td>2.8%</td>
<td>2.6%</td>
<td>1,936.96</td>
<td>1,941.94</td>
</tr>
<tr>
<td>Emerging</td>
<td>Ecuador</td>
<td>4.0%</td>
<td>4.0%</td>
<td>3.1%</td>
<td>3.0%</td>
<td>N/A**</td>
<td>N/A**</td>
</tr>
<tr>
<td></td>
<td>Peru</td>
<td>3.6%</td>
<td>5.1%</td>
<td>3.2%</td>
<td>2.3%</td>
<td>2.80</td>
<td>2.75</td>
</tr>
<tr>
<td></td>
<td>Venezuela</td>
<td>-3.00%</td>
<td>-1.00%</td>
<td>64.30%</td>
<td>62.90%</td>
<td>15.52</td>
<td>21.95</td>
</tr>
</tbody>
</table>

Please note:
1. IMF assigned Argentina inflation “N/A” due to data quality and government intervention. You can use it as noted or use the prior data of 31% inflation with annotation.
2. The MXN exchange rate is 14.74 per US$: we used the IMF from October (the latest).
4. **As of September 2000 Ecuador discontinued use of Sucre (ECS) in favor of US dollar.

Source: International Monetary Fund, World Economic Outlook Database, October 2014
US life-annuity
Sales benefit from consumer confidence and personal wealth
Market summary

Prospects are generally upbeat in 2015 for providers of life insurance and annuities in the US. Insurers can expect to build upon recent improvements in annuity sales, as credit rates continue to increase and customers return to simplified, tax-deferred products. Life insurance sales will benefit from rising levels of consumer confidence and personal wealth, both driven by the ongoing economic recovery and expectations for gradual increases in interest rates (see figure 1 for industry growth and profitability).

Yet, these opportunities are not evenly distributed across the industry, and companies are challenged to break into underpenetrated markets with new products, strategies and advice models. To execute these strategies, life insurers will need to leverage technology advances in distribution, underwriting and customer service.
At the same time, competition is intensifying in the life insurance-annuity market. Both carriers and consumers are realizing the benefits of expanded access to technology, as new capital entrants disrupt traditional market positions. New players are developing new business models and market approaches to better align with customer expectations. However, these actions by non-traditional capital sources also have increased regulatory scrutiny of new business models, investment strategies and risk profiles. This adds to the continuing debate on the broader areas of risk management and regulation that carriers face.

Figure 1: US life insurance industry growth and profitability

In 2015, distribution priorities will continue to focus on expanding market opportunities. While the high-net-worth market drives sales and attracts distributor attention, the financial protection and savings needs of the middle-market remain underserved. The challenge for insurers is to execute an efficient middle market strategy, without disrupting the industry’s high-net-worth mainstay.

A digital presence through the internet, mobile technology and social media has become the new “storefront.” Digital advances will enable insurers to effectively reach more diverse and demanding customers and distributors. Providing self-service capabilities will empower both constituencies and widen participation in the voluntary marketing channel. Clearly, customers will continue to search the internet for information on financial services and insurance. The rise in consumer education and self-service capabilities will have broad implications for both the life insurance distribution and advice models, as well as the cost of those services.

Straightforward products that are easy to understand and compare will be of great appeal to consumers. Such products also lead to more streamlined transactions, increased efficiency and broader market reach. Streamlined underwriting through data analytics based on electronic health records, prescription databases, credit information and other big data sources will help control underwriting risk and speed product application approval and delivery times. While these technologies can transform the back office, they increase privacy and cybersecurity risks. As more applications and technology solutions are based in the cloud, this creates additional third-party exposures.

On the regulatory front, the implementation of Own Risk and Solvency Assessment is compelling carriers to shift from preparation and testing to execution. The differences in fiduciary standards among various regulatory agencies, such as the Financial Industry Regulatory Authority, the National Association of Insurance Commissioners and the U.S. Department of Labor will be resolved in 2015, requiring companies to adjust their distribution and marketing efforts to comply with the new standards. New regulations also may encourage new product and marketing opportunities, such as products addressing the new “Qualified Longevity Annuity Contract” definition. These changes are underway in an era of increasing tension between federal and state regulators, with the new Federal Insurance Office flexing its muscles as the NAIC and state insurance commissioners fight back to preserve their roles. In this combative environment, insurers are increasingly caught in the middle.

External forces in 2015

<table>
<thead>
<tr>
<th>Interest rates and economic factors</th>
<th>Consumer confidence</th>
<th>Customer needs</th>
<th>Technology changes</th>
<th>Regulations</th>
<th>Capital adequacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slight interest rate rise, but still near lows; slow economic growth</td>
<td>Confidence improving</td>
<td>Needs and expectations increasing</td>
<td>Pace of change dramatic</td>
<td>Steady increase and new regulators appearing</td>
<td>Capital rebuilt, continued accumulation and new entrants</td>
</tr>
</tbody>
</table>
US life-annuity insurers that better understand and accept these forces of change are in a position to seize competitive opportunities by modernizing their products, services, operations and distribution.

Specifically, successful insurers in 2015 will:

1. Reposition distribution strategies to expand market opportunities
2. Embrace digital as the new storefront
3. Develop simplified products to expand customer markets
4. Transform back office systems and processes
5. Enhance data security
6. Adjust to new competition from alternative capital sources
7. Proactively address the uncertain regulatory environment

Reposition distribution strategies to expand market opportunities

Digital and internet-based technologies will continue to alter consumer expectations and behavior in 2015. In response, life-annuity insurers will expand their distribution beyond the traditional paradigm. To succeed in this developing environment, insurers need to reposition their products to fit the new distribution models.

As exemplified by shopping and purchasing trends in diverse industries, consumers are increasingly buying insurance and savings products online. Automobile insurance is a case in point, with more consumers buying coverage on the internet and without the involvement of traditional insurance agents. The purchase of health insurance has similarly moved in this direction, particularly with respect to the online exchanges created by the Patient Protection and Affordable Care Act.

Consumers also have turned to online banking and investment services to manage their finances. In fact, many investment firms now offer online financial planning tools complementing more personal financial planning methods. Aggregator sites enable consumers to compare prices and products before purchasing insurance and annuity products. The increasing trend toward wearable tech devices, already seen in health and fitness, may also impact the insurance industry. These revolutionary changes are shifting the traditional role of insurance agents and advisors.

To address the digital expectations of customers, successful insurers in 2015 will invest further in direct-to-consumer advice models, online marketing and online self-service capabilities. Focused testing of online sales, perhaps with some internal agent support, will be another
ongoing effort. These investments will enable insurers to build competencies that may one day evolve into significant online distribution capabilities.

To meet the expense of these distribution changes and respond to more price-conscious online consumers, insurers will re-evaluate their pricing margins and recalibrate compensation structures. The need to adjust compensation may intensify, as various regulatory agencies settle their differences around fiduciary standards and advisor compensation.

Insurers are expected to expand their distribution landscape in 2015. To reduce costs and meet customer expectations, they will need to simplify products and reduce friction in the sales process. As they expand distribution beyond traditional agents, insurers will seek greater opportunities for competitive differentiation.

Embrace digital as the new storefront

Social media will continue to play a crucial role in insurer marketing, as will mobile technologies for marketing and sales support, administration and customer service. A survey\(^1\) of the digital practices of more than 100 leading US and European life and non-life insurers indicates that most insurers are focusing their digital efforts in marketing (83% of respondents) and sales (78% of respondents). The survey further demonstrates that insurers are as focused on improving and streamlining the processes around the purchase of life insurance as they are on designing and developing new products. Leading insurers will leverage a digital presence to outgrow their competitors, increase self-service capabilities, reduce business risk and enhance productivity.

The rapid pace of change in online access to insurance products challenges insurers in presenting a consistent digital customer experience. Insurers also have struggled with uneven data capture and analysis of consumer online activities. They will need to retool their digital and distribution strategies and systems to create a consistent omnichannel customer experience, breaking down product, customer and prospect data silos. By delivering superior and homogeneous customer experiences across all digital touch points and effectively capturing and analyzing online consumer behaviors, successful insurers will achieve competitive differentiation in 2015.

The ability to accurately measure social network activity and mobile usage is critical to making effective resource allocation decisions. Marketing teams must track the business impact of their companies’ expanded digital presence on sales, customer loyalty and customer satisfaction through definitive metrics. These measures must withstand management’s scrutiny regarding the total cost of ownership and return on investment. In other words, to build a future-ready digital insurance presence, carriers must be able to assess the true financial benefit that digital currently is providing the business.

To build a future-ready digital insurance presence, carriers must be able to assess the true financial benefit that digital currently is providing the business.

Develop simplified products to expand customer markets

As insurers seek to expand their market presence, they are reaching beyond the high-net-worth market to the mass affluent and middle market (see figure 3). These segments are more likely to use online product comparison sites for informational purposes and pricing insights. Simplified products with modular riders tend to be more successful with middle-market consumers perusing these sites. This, in turn, will give innovative companies a competitive advantage as they expand their market presence.

A case in point is the attractiveness of combination products, such as a life insurance policy with a long-term care accelerated benefit rider. The rider avoids the “use it or lose it” problem associated with stand-alone long-term care products, while keeping the base insurance product in force for a longer period of time – a benefit to both the company and the customer.

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1 EY Global Insurance Digital Survey 2013, *Insurance in a digital world: the time is now.*
The customary approach of layering new technology on top of outdated systems and processes is highly inefficient in the current competitive marketplace. Today’s evolving business models demand more simplified and streamlined processes matched to appropriate technology solutions.

The inefficiencies of legacy systems severely affect multiple operating areas and inhibit company growth. Underwriting processes, in particular, need to change dramatically and immediately. An outdated underwriting process alienates customers and distributors, while failing to take advantage of recent advances in data analytics. This compels slower and less effective underwriting decisions, with a corresponding impact on sales.

Transform back office systems and processes

In the current low-interest-rate environment, operating efficiency will continue to be a concern, forcing insurers to rationalize their cost structures. To attain the agility and speed demanded by competitive pressures and customer preferences, insurance companies must simplify their systems, processes and structures.

In a 2013 EY global insurance digital survey, 80% of respondents listed “legacy technology constraints” as a top inhibitor to digital growth. Yet, many insurers still operate core systems on multiple platforms that are frequently incompatible, inflexible, antiquated and expensive to maintain.

Insurers are developing various modular products with different riders attached to various base products. For example, companies are creating riders to provide protection for specific life events, such as a disability, critical illness or long-term care need, in response to consumer concerns in the aftermath of the financial crisis. Riders may be purchased at issuance of the base product.

Underwriting the base product can be streamlined through the use of data analytics of electronic health records, prescription databases, credit information and other third-party sources. Data analytics also can be leveraged to control underwriting risk and speed the application approval process. By focusing on pure protection events and avoiding financial guarantees, these more simplified base products and riders create a more acceptable risk profile for the insurer, while addressing current consumer concerns.

Companies are creating riders to provide protection for specific life events, such as a disability, critical illness or long-term care need, in response to consumer concerns in the aftermath of the financial crisis.

Figure 3: Household financial assets

Holdings of life and annuities* by household segment
2013 (percent)

<table>
<thead>
<tr>
<th>Household Segment</th>
<th>2013 Holdings</th>
</tr>
</thead>
<tbody>
<tr>
<td>High net worth</td>
<td>51.8%</td>
</tr>
<tr>
<td>Middle market</td>
<td>29.2%</td>
</tr>
<tr>
<td>Mass affluent</td>
<td>11.9%</td>
</tr>
<tr>
<td>All other</td>
<td>6.2%</td>
</tr>
</tbody>
</table>

Life and annuity* percent of financial assets by household segment
2013 (percent)

<table>
<thead>
<tr>
<th>Household Segment</th>
<th>2013 Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>High net worth</td>
<td>3.8%</td>
</tr>
<tr>
<td>Mass affluent</td>
<td>6.3%</td>
</tr>
<tr>
<td>Middle market</td>
<td>7.4%</td>
</tr>
<tr>
<td>All other</td>
<td>7.8%</td>
</tr>
</tbody>
</table>

*Cash value life insurance, excludes term
Successful insurers in 2015 will optimize and align their sales, customer service and advisory processes with technology. This back office and process transformation must occur across the entire organizational structure to address both internal requirements and customer needs. Systems and processes must be owned and led by local business units, and aligned with a strong centralized structure, enterprise architecture and overall strategy.

Addressing legacy system inefficiencies is a critical challenge for life-annuity insurers in 2015. Organization-wide transformation will be complex and may take years to finalize. Insurers that reach this finish line first will be more agile and adaptable to changing market and stakeholder preferences. Those carriers that fail to rise to the challenge will face new digital competitors – companies unencumbered by legacy infrastructure and outdated processes and thus more responsive to evolving market demands.

**Enhance data security**

Data security has long been a major concern for insurers and other companies that handle sensitive customer personal information. Newer IT practices, such as cloud computing, have exposed insurers to additional technology security risks, despite the operational value. For instance, insurers risk losing control of data security because multiple external parties are involved in cloud computing.

Insurers risk losing control of data security because multiple external parties are involved in cloud computing. Unauthorized data access can result in adverse consequences, such as loss of reputation among consumers and distributors, regulatory action and legal responses. Data gathered in underwriting life insurance can be especially sensitive. As large data sets are used as part of modeling through cloud computing, access to these models can expose proprietary information, or the modeling results themselves could be altered in an unsecure environment.

Increased regulatory oversight has increased the need for enhanced data security. Data sovereignty issues also have arisen for international companies. While data may be stored on servers physically located in one country, customers may reside in a different jurisdiction with more stringent data security rules. In March 2014, the European Union Parliament overwhelmingly voted in favor of stronger data protection requirements for individuals, reinforcing the requirements for explicit permission to transfer certain types of personal data from one country to other countries. These new data transfer restrictions extend to subsidiaries and other parts of a company, thus affecting internal risk management.

Successful insurers in 2015 will enhance their data security, navigate and evaluate ongoing regulatory requirements, and...
Insurers that design modular, simplified products supported by streamlined distribution and policy maintenance processes can quickly respond to rapid changes in consumer needs and product preferences.

Develop enterprise-wide processes and procedures to control and monitor the security practices of third-party providers. The effectiveness of these activities will be routinely and closely scrutinized and reported to the board of directors of these insurers.

Adjust to new competition from alternative capital sources

The new companies in the life-annuity market have reshaped the competitive landscape. Many are large investment firms that recognize the market potential to capture retirement assets. The firms have become active acquirers, leveraging their significant investment management capabilities and expertise. The same skills are helping new competitors to offer retirement products with attractive credit rates. As investors purchase blocks of life insurance, the firms are becoming full-service multi-line insurers. These new players are pursuing a broad range of strategies, challenging traditional insurers to re-evaluate their competitive approaches.

The new competitors have the potential to make significant inroads into the market, given their unique business models, higher risk tolerance and financial capacity to gain market share. They also increase pressures on traditional insurers to maintain profitability and growth. While traditional insurers may not have an investment advantage over these new entrants, they will need to exploit their distribution channel advantages, financial strength, fundamental processing efficiencies and capabilities in order to maintain and grow their market share.

This new capital from non-traditional sources has attracted regulatory scrutiny on policyholder security, including appropriate capital levels, riskiness of investment strategies, use of captive insurers and affiliated transactions. These concerns may not be confined to investor-owned insurers, as all insurers face an increased risk of new regulations. Insurers will need to monitor regulatory developments to ensure both a level playing field and avoid unintended consequences. At the same time, the new capital can create additional opportunities for existing insurers seeking to rationalize their product portfolios. Recent entrants can represent new markets for insurers seeking dispositions of non-core books of business.

Proactively address the uncertain regulatory environment

Multiple legislative and regulatory bodies implemented new regulations in the immediate aftermath of the financial crisis, creating new demands on the industry. Longer-term regulatory projects that began before the crisis are continuing, with a few broadening in scope. Consequently, insurer management teams are under pressure to respond to multiple regulatory requirements and disparate goals sought by competing regulatory authorities.

A case in point is the regulatory differences in capital and systemic risk. Some large life insurers have been designated systemically important financial institutions (SIFI) by the Financial Stability Oversight Council in the US, while these and other internationally active life insurers also have been designated global systemically important insurers (G-SII) by the Financial Stability Board. Although the designations were originally announced in 2013 and continue to be updated, it remains unclear if there will be additional regulatory expectations for SIFIs or G-SIIs. Other solvency and capital issues have been raised, especially regarding the use of captives by life insurance companies.
The regulatory bodies are also under pressure. Consequently, regulators have increased their demands for information from insurers and are more apt to closely scrutinize submissions. Insurers are caught between competing forces. Regulatory competition exists at all levels – state regulators, national regulators and international regulators are all exercising their respective points of view.

The regulatory pressures are likely to increase through the next three to five years. In this environment, companies must focus on future laws and regulations and develop associated plans. The increasing regulatory demands for information may not conform to existing reporting structures, requiring insurers to build advanced, integrated technology systems and processes to respond to these disparate information requests. As a result of these investments, companies’ senior management will have a more holistic view of their organizational risk, leveraging a single set of tools for oversight and testing, as well as reporting to key stakeholders.
US property-casualty
On its way to a second year in a row of strong performance
Market summary

Current economic and marketplace trends in the US suggest a continuation of modest gross national product (GDP) growth and a low rate of inflation in 2015. Despite this generally positive macroeconomic environment, increasing risk and economic uncertainty continue to prevail. Consequently, the US property-casualty market is confronted by contradictory signals of opportunity and challenge.

For example, corporate revenue growth is strong and job growth is increasingly improving, but job wage growth has lagged. Similarly, core US inflation has remained within the Federal Reserve's targeted range, but food and energy prices are volatile and medical inflation continues. Volatility in global economic conditions further complicates the macroeconomic environment. The anticipated interest rate recovery has stalled, and volatility in the financial markets may accelerate.
On the surface, the property-casualty industry appears well on its way to a second year in a row of strong performance. Combined ratios and return on equity (ROE) have reached levels not seen since before the financial crisis (see figure 1). This strong performance has helped strengthen balance sheets, increasing both surplus and invested assets. However, as of year-end 2014, ROEs were beginning to fall from a combination of capital accumulation, competitive pricing, weak investment returns and rising loss expense.

In this environment, pricing is constrained by capital accumulating faster than insurance exposures. The benign catastrophe results over the last two years have pressured reinsurance rates, which have correspondingly depressed pricing in primary lines. Additional pressures are anticipated if alternative capital providers, such as hedge funds, further their expansion into the casualty insurance business using predictive analytics. Several years of profitable property catastrophe reinsurance risk assumption have bolstered the alternative providers in their expansion plans.

As margin pressures mount in the industry, this increases the emphasis on expense management through technology upgrades and better integration of business units. To reduce costs, property-casualty insurers that grew over the past decade via acquisitions will need to increasingly focus on the post-merger integration of their physical plant, people, processes and data resources. Weak investment returns are another factor in companies’ declining profitability, since maturing investments are being reinvested at lower yields. This factor is compelling carriers to assume more credit and liquidity risk in their investment portfolios. To manage these strains on profitability, insurers need to continue to invest in technology solutions across the entire enterprise that respond more effectively to ongoing competitive pressures, increased risk and uncertainty.

Market leading performance in the property-casualty sector is being driven by investments in technology, distribution and risk management systems. As mission-critical information becomes more accessible, this is driving more assured data-driven business decisions in the C-suite. To segment and reach profitable customers, insurers also are using new technologies to develop and manage multiple distribution and communication channels. Nevertheless, new competitors leveraging more available and cost-effective solutions in analytics, communication and infrastructure may pressure the market’s technology leaders in 2015. In response, leading companies are migrating from stand-alone technology projects to an environment of continuous technological improvement.

The likelihood of increasing burdens and jurisdictional competition will continue to characterize the regulatory milieu in 2015. Regulatory bodies have proliferated at the international, federal and state levels. All will likely increase their demands for information, reporting and compliance,
with regard to accounting, solvency, fair practices, transparency, governance and marketplace equity. In the US, jurisdictional competition is evidenced by the potential overlapping oversight of the National Association of Insurance Commissioners (NAIC), state insurance regulators and the new Federal Insurance Office (FIO). Navigating possible conflicting rules and regulations may increase both human resource and financial capital costs.

These various factors indicate that 2015 may present a more challenging market environment for property-casualty insurers. Companies that proactively manage these evolving events will differentiate themselves from those that respond reactively. In this regard, insurers need to invest in new markets, products and approaches to existing customers. To grow the top line will require organizational realignment, a commitment to innovation and the implementation of advanced data analytics. The recruitment and retention of superior management talent is a key challenge, given that the role of underwriters, claims and service personnel is evolving. With organic growth uncertain, management must explore acquisition opportunities, particularly more targeted strategic expansion as opposed to large-scale consolidation. The ability to successfully plan and operate in this fast-changing environment is crucial, as the variable growth US economy will pressure insurance company management to assume greater risk, while determining which of these risks is economically sound.

To remain industry leaders, successful property-casualty insurance companies will need to react to these macro and industry challenges in 2015 in the following ways:

1. Respond to increasing competition with strategic cost management and laser-focused pricing
2. Engineer an enterprise data excellence strategy
3. Improve customer connectivity by expanding distribution and customer service
4. Retool operations for new and evolving risks
5. Proactively address multiple regulatory requirements and potential tax considerations
6. Address investment performance and capital management

Respond to increasing competition with strategic cost management and focused pricing

In 2015, insurers are entering an uncertain operating environment marked by slower premium growth and increasing competition. Personal lines exposures remain below historical levels (see figure 2), further pressuring top-line growth. Maintaining good profit margins requires insurers to focus on cost, efficiency and more refined segmentation and pricing.
strategies. For the past three years, insurers have been able to maintain stable expense ratios due in large part to premium growth. However, if rates ease in 2015, premium growth may not be able to keep up with expense growth.

The continued expansion of aggregator and direct-to-consumer business models is enhancing insurance product cost transparency, while the need to operate multiple distribution and communication channels is increasing carrier expenses. Additionally, many insurers are just beginning to rationalize previously acquired operations and legacy systems. To improve efficiencies and be more competitive, insurers must attend to redundant operations, processes and data resources. Cost reduction is no longer just an operational issue; it is now a competitive necessity. More forward-thinking companies will aggressively tackle their costs.

Technology solutions are critical to achieving strategic cost management and customized pricing and segmentation goals. Sustainable competitive advantages flow from precise, segmentation and optimized customer pricing using internal and third party data. Micro-segmentation of customer risk attributes is equally important. Leading insurers also are improving their profitability through integrated cloud computing solutions that cost less than on-premise technology. They are further trimming expenses by implementing straight-through processing to reduce duplicate data entry across functions.

Several approaches are available to insurers to improve cost effectiveness, such as selective offshoring, shared service centers, process optimization and third-party spending controls. Some insurers also have established onshore captive service centers in lower-cost geographies with educated workforces to replace their existing, higher-cost infrastructure.

In the effort to reduce expenses, insurers must not limit their ability to build new capabilities in today’s competitive environment. Strategically, they must weigh prospective expense reductions against their respective goals and competitive differentiators. In turn, this should guide better decisions to reduce costs and improve business performance. Identifying the most effective long-term cost reduction opportunities is important in these deliberations.

Engineer an enterprise data excellence strategy

Property-casualty insurers in 2015 must embrace an enterprise data excellence strategy that addresses all aspects of
Improve customer connectivity by expanding distribution and customer service

Reaching the insurance customer in a variety of formats is increasingly becoming a competitive necessity, given the expansion of channel choices available to consumers from other industries today. Adding channels and offering alternative modes of communication improves client access, enhancing competition for the most profitable customers. To address competitive distribution challenges, insurers first need to expand their methods and modes of customer interaction.

Competitive pressures have created the need for insurers to evaluate the effectiveness of their traditional customer connection points. In personal lines, some companies have strategically developed a suite of capabilities that meets the full spectrum of customer distribution and service needs. Other carriers are adding
Integrating these channels to provide a seamless customer experience across an insurer's sales and service activities is the next competitive differentiator.

Retool operations for new and evolving risks

As insurers pursue top-line revenue growth in new products, the effective identification, analysis and mitigation of new and emerging risks is increasingly important. Throughout the global economy, new business models are replacing traditional services while altering customary risk patterns. In this new sharing economy, services provided by
Proactively address multiple regulatory requirements and potential tax considerations

The growing volume and complexity of insurance regulations, in addition to the various overseers of these rules such as the NAIC and FIO, compel insurers to invest in more flexible technology, data analytics and skilled management. While more stringent regulations may impede growth, increase expenses and divert valuable human resources, the impact will be less for insurers that select appropriate technology and data solutions to address their broader risk management and reporting demands.

Figure 4: Worldwide “internet of things”

Installed based of IP-connected devices*


*Excludes stand-alone sensors, smartphones, tablets, PCs and wearable devices.
Insurers need to expand their management pools with management talent that is well-versed in regulatory and reporting matters. Demands from multiple and potentially conflicting jurisdictions require solutions with enterprise-wide application. Investing in the efficient use of data to satisfy current and future regulatory demands will be more cost-effective if accompanied by judicious staff additions to respond to increasing regulatory information requests.

In 2015, insurers with more than $500 million in direct premium ($1 billion for insurance groups) are required to comply with the NAIC’s requirement to submit annual reports of their Own Risk and Solvency Assessment (ORSA). The scope and detail of the data to be provided vary according to the nature and the complexity of the insurer. Nevertheless, insurers must provide the quantitative methods they used to assess risks and the impact of these risks on their balance sheets. They must also submit a description of the company’s processes for model validation. Although ORSA requirements are an annual process, they may be iterative—should an insurance commissioner request additional detail, the insurer must be in a position to provide robust data, as well as a detailed understanding of risks, their interrelationship and how these risks can be mitigated. In addition, ORSA is likely to evolve to entail additional reporting challenges.

Insurers also need to be ready to respond to increased data requests from the FIO, which has indicated interest in developing standards for personal lines insurance, specifically governing pricing and rate regulation practices. The FIO’s potential involvement in consumer protection initiatives, such as the affordability of personal lines insurance in underserved communities, would increase data demands in the future. At present, it is unclear if the information requests from new regulators will conform to standard statutory information or accounting conventions, increasing their potential impact on insurers.

Finally, insurers should monitor the proposed tax law changes currently in discussion in Congress, such as the Camp proposal. In the proposal’s current draft are changes to how property-casualty insurer loss reserves would be treated for tax purposes.

Figure 5: US property-casualty industry invested assets

*Percent of total bonds
**Percent of cash and invested assets
Source: A.M. Best Company; EY analysis, 2014
Address investment performance and capital management

After a brief initial rise in interest rates in mid-2013, rates have since retreated. The concerns over a rapidly rising interest rate environment appear to have given way to anxiety over continued low rates. Although the property-casualty industry’s investment income is improving modestly, this is primarily due to new cash flows and invested asset growth, as reinvestment yields continue to languish. While the industry’s embedded yield appears to have bottomed out in 2014, it is not expected to rise appreciably in 2015.

As a result, insurers continue to seek enhanced yield and investment income through changes in credit quality, liquidity and maturity. However, the prolonged investment market challenges leave insurers with few ways to achieve these aims. One of the more significant shifts in bond allocations has been the migration toward lower-rated NAIC-2 category assets (BBB rated credits). Insurers also have taken on more liquidity risk by investing a greater portion of their bond portfolios into private placement securities. While these actions have enhanced overall yields at the margin, they have not mitigated insurers’ credit exposures and concentration risks.

Given an abundance of capital, most insurers are re-evaluating their investment allocations to enhance performance and improve diversification. Among the asset classes that insurers are considering are common stocks, loan products, master limited partnerships and hedge funds. While these alternatives can improve an insurer’s investment risk profile and provide added diversification, they require greater sophistication in risk modeling and monitoring, in addition to both internal and external reporting.

In today’s increasingly demanding regulatory environment, these new investment allocations need to be modeled and better understood. To do this, insurers increasingly need global enterprise risk management capabilities, improved risk analyses and technology solutions that measure investment risk across multiple asset classes and economic scenarios.

To optimize capital deployment, insurers will continue to pursue capital management strategies such as share repurchases, extraordinary dividends and even merger and acquisition transactions. Management will rely on both internal and external capital models to balance their return objectives with regulatory, solvency and rating agency capital margin requirements. Expectations are for global political and economic volatility and uncertainty to continue to influence the capital markets in 2015, requiring insurers to take a more proactive approach toward managing their investment and capital management strategies.

Among the asset classes that insurers are considering are common stocks, loan products, master limited partnerships and hedge funds.
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EYG No. EG0233  
BSC No. 1411-1356096  
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