2014
Global insurance outlook
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Executive summary
In 2014, the global insurance industry is finally emerging from the combination of financial turmoil and economic uncertainty that has challenged international property-casualty and life-annuity insurance companies for the last several years.

Although it remains premature to unequivocally state that the difficult times are behind the industry, many signs point to significant pockets of opportunity. In Asia-Pacific, for example, rising individual wealth and aging populations are enticing areas of product expansion and revenue growth.

Latin America continues to offer substantial growth potential to insurers that cleverly pursue specific niches. And in the United States, Europe and Canada, many insurers have rebuilt their capital positions in the wake of the financial crisis and are poised to wisely allocate it to competitive advantage and strength. All in all, the industry appears at the threshold of much better times ahead.

Nevertheless, complex challenges lay ahead, chief among them the protractedly low interest rate environment. The question in 2014 is not how low rates may go, but how low they may remain. Another lingering challenge is the often-confounding array of stringent international and national regulations spawned by the financial crisis. Obviously, these enhanced regulations create significant compliance and governance burdens for insurers. Adding to these burdens is the implementation timing of many laws, which remains uncertain.

Technology also has upped the ante for all insurers, particularly in relation to today’s empowered consumers both researching and buying insurance on the internet. Many insurance companies also are encumbered by legacy systems incapable of providing the big data analytics guiding superior sales and market segmentation strategies, not to mention improved underwriting, claims and other systems. Insurers must develop a stronger digital presence, investing in technologies that address the enhanced service expectations of consumers, and develop a comprehensive enterprise data analytics strategy to improve customer targeting, product design and agency management.

Certainly, given the prospect for slim profit margins in 2014, insurers must continue to identify opportunities for top line and bottom line growth. In this regard, successful insurers will develop a customer-centric culture focused on the distinctive needs and expectations of buyers. There remain many opportunities for insurers to garner a competitive advantage and thrive.

Our Global insurance outlook explores these many opportunities and challenges confronting global insurance organizations in 2014. In this report, we offer our perspective on the insurance markets in Asia-Pacific, Europe, Latin America, Canada life-annuities, US property-casualty and US life-annuities.

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The challenges and opportunities by region:

**Asia-Pacific**

- While the slowing growth rate of the economy and low interest rate environment challenge insurers, rising individual wealth and aging populations create opportunities for insurers to introduce new products.
- Property-casualty and health insurers may benefit from the new free-trade zone in Shanghai, which permits the establishment of international health insurance institutions and will increase demand cargo and liability insurance.
- As regulatory changes open the savings market to new entrants, insurers need to evaluate methods of product development and distribution, such as forming a partnership with an existing fund manager.
- Technology has changed the way consumers engage with insurers, putting the onus on carriers to develop digital distribution strategies that improve customer experience and provide comprehensive support.
- While trade liberalization is creating market opportunities in ASEAN countries, insurers must be alert to evolving regulations and their region-by-region differences.
- Insurers should seek to implement data analytics to improve competitive standing and identify other areas to reduce expenses.

**Canadian life**

- As the life insurance market builds upon more positive economic factors, successful insurers will leverage the operational flexibility they’ve developed over the last few years to seize competitive opportunity.
- Despite more bullish external forces, life insurers must continue to closely monitor interest rates, equity and housing markets, employment, and consumer confidence and personal wealth.
- Renewed focus on asset management and wealth management compels development of more innovative, attractive products and improves profitability in tax, sales and asset-liability management.
- Insurers must improve expense management and underwriting by streamlining existing processes, increasing data analytics capabilities, outsourcing and focusing more diligently on core operations.
- Efforts must be waged to more fully capture and understand changing consumer demographic information to guide product and distribution strategies and expand growth opportunities.
- More stringent regulatory and accounting changes compel insurers to improve their modeling capabilities, data quality, data governance and the level of detail provided by their reporting systems.
As the Eurozone and UK recover from the recent economic turmoil, successful insurers will be those that simplify their organizations and business models to create more efficient operations that can seize emerging growth opportunities.

Insurers must keep pace with evolving regulations, which are becoming more stringent, affecting everything from capital requirements, to commission rates and customer care.

While the region’s aging population and the personal and commercial non-life markets present significant opportunities to increase sales, insurers must maintain focus on profitability.

As the low interest rate environment continues, insurers must retool their investment strategies to increase investment yields and be adequately compensated for increased risks added to the portfolio.

As the economy improves, insurers must develop a stronger digital presence, investing in technologies that address the enhanced service expectations of consumers purchasing insurance on the internet.

The development of a comprehensive, cross-functional enterprise data analytics strategy will improve customer targeting, product design, pricing, agency management, underwriting, claims and reporting.
**Latin America**

- Despite growing risks of inflation, substantial catastrophe exposures and currency exchange rate volatility, the region presents rich growth potential to competitively astute insurers that pursue specific niches.
- Insurers that develop efficient distribution alternatives are in a good position to seize business from traditional sales channels that are not growing in line with expanding populations or addressing more demanding consumer expectations.
- In an environment of reduced margins, successful insurers must identify opportunities for top line and bottom line growth, executing strategies such as a customer-centric culture focused on distinctive needs and expectations.
- As insurance regulation evolves toward risk-based capital approaches that increase operational complexity, insurers must develop more sophisticated structures for management, information and capital systems.
- To improve capital efficiency and profitability, and prepare for more digital-focused competition, insurers must overcome legacy insurance technology with investments in tools that enhance underwriting and innovate distribution.
- Several skill sets, such as data analytics and underwriting, are in short supply, compelling the recruitment of this talent from universities, other industries and bancassurers, which are providing the needed training and development.

**US life-annuity**

- In the highly competitive market conditions, insurers must deepen their relationships with customers, which is vital to retain this book of business and maintain sustained, profitable growth.
- As stagnant sales and low investment yields constrain profits, insurers must streamline operational models and cost structures, resolving legacy system challenges to achieve long-term operational excellence and profitability.
- Now that the transformation to improved data systems is underway, insurers must invest in enterprise data excellence to improve data quality, access, integration, security and governance.
- Having rebuilt their capital structure to weather the post-financial crisis, insurers can enhance shareholder returns by improving the yield on investments in products and operations and restructuring capital through captives and debt.
- Despite the still uncertain implementation dates of many complex regulations issued in the aftermath of the financial crisis, insurers must stay ahead of the curve by improving their governance structures in anticipation of the changes.
- As life insurers confront multiple and often conflicting requirements in the rapidly changing regulatory environment, they must enhance their capacity to understand and communicate these changes to decision-makers.
US property-casualty

• In the low interest rate environment, insurers must invest internally in technology and operations, leveraging broad-based technology solutions to improve underwriting, product development, claims and distribution.

• A key objective is enterprise data excellence, in which efforts are waged to improve data quality, access, integration, security and governance, as well as to establish data policies and standards.

• Increased risk retentions by customers in the aftermath of the recession pressure insurers to rationalize their complex portfolio of products, simplify the delivery and processing of these product offerings and reduce frictional costs.

• The still-fragile economic recovery and the competitive dynamics in certain market segments indicate that insurers that exploit pockets of opportunity – global, geographic, product and demographic – will be well positioned for growth.

• In the still-challenging investment environment, insurers must invest in robust economic capital modeling and enterprise risk management tools that assess evolving liabilities, capital structures and business plans.

• As insurers confront the escalation of regulatory demands for information from an expanding array of competing jurisdictions, they must stay ahead of these pressures and expeditiously enhance record-keeping and reporting capabilities.
Asia-Pacific

Continuous evolution
In the past decade, insurance companies have experienced some dramatic shifts. Many of the trends that we have discussed in previous outlooks have changed the shape and direction of the industry. Issues include increasing customer sophistication, growing use of technology across all aspects of the insurance value chain, greater collaboration and alignment with insurance regulators, and significant innovation in the products being offered.

In 2014, insurers in the Asia-Pacific region will continue to face slower economic growth, a lingering low-interest-rate environment and regulation that is wider in scope and severity at the national and regional level. However, the liberalization of trade barriers (as evidenced by the Shanghai Free-Trade Zone in the fall of 2013 and the 2015 target date for ASEAN integration) and the continuing increase in middle-class and high-net-worth consumers is highly favorable for the insurance industry.

As insurers in Asia-Pacific assess these challenges, they are responding with cost control and internal process improvements. Many are consolidating cumbersome legacy systems and implementing data analytics to build more efficient operations and improve underwriting and claims practices.

**Successful insurers in Asia-Pacific in 2014 will:**

- Deploy products to meet changing consumer needs
- Exploit pockets of higher growth
- Develop digital distribution strategies
- Get ahead of regulatory developments
- Implement data analytics for competitive advantage
- Identify areas for expense reduction
Deploy products to meet changing consumer needs

EY expects the Asia-Pacific region’s share of the global middle class to nearly double, rising from 28% in 2009 to 54% in 2020. The increasing individual wealth and aging population will create opportunities for insurers to introduce new products to consumers that protect their hard-earned financial and physical assets.

Health and non-life products

Demand for health insurance is expected to rise for several reasons: the aging population, strain on public resources and rising consumer affluence. Currently, 10% of the population in Asia is over 65 years old, but that number is expected to double within the next three decades, creating a need for various insurance solutions.

Many governments in the region, including those in India, Indonesia, Malaysia, the Philippines, Singapore and Vietnam, assume less than 50% of health care expenditures (an estimated US$197 billion in 2013, according to Swiss Re). The rest is covered by private insurance or paid for by individuals, creating an opportunity for private insurers to supplement the public sector provisions with their products.

In China, the establishment of foreign professional health insurance institutions in the country’s new Shanghai Free-Trade Zone has the support of the China Insurance Regulatory Commission (CIRC). This implies that high-end health insurance is increasingly important and further supports China’s growing interest in the global health insurance service system.
Across Asia-Pacific, the exponential rise in automobile ownership highlights the need for motor insurance. The number of privately owned automobiles in China exploded from virtually nil in 1985 to an estimated 120 million cars today – and is expected to grow to 200 million vehicles by 2020. At present, motor insurance is the largest non-life insurance line in the country. Compulsory third-party liability alone accounted for 72% (400 billion yuan) of China’s aggregate non-life premium in 2012. Seven non-Chinese insurers have entered the third-party liability automobile insurance market since it was opened to foreign competition in 2012. Rising Asian affluence is not only supporting the automobile market, but it is also generating more travel abroad and a greater need for travel insurance.

Savings products

Regulatory changes are opening the savings market to new entrants. In China, for instance, the Securities Investment Funds Law liberalizes regulations to permit the formation of insurer-based mutual funds. The Asia Region Funds Passport is another key regulatory development, streamlining the process by which the fund managers of Passport members in one country market their savings products in other Passport member economies. Implementation is targeted for 2016.

As insurers consider opportunities in the savings market, they need to evaluate methods of product development and distribution. Forming a partnership with an existing fund manager to access a wider range of products is one channel; another is to offer internally developed and managed funds utilizing the existing sales force. Insurers also could build on existing bancassurance relationships. Studies indicate that nearly half (45%) of more than 470 banking entities across mainland China, Hong Kong, India, Indonesia, Japan, South Korea, Thailand and Vietnam offer investment-related life insurance or retirement savings products.

To succeed, insurers must evaluate the impact pure savings products will have on internal cash flows, capital and risk requirements. Systems may need to be built or integrated with existing processes to handle this new savings business.
Exploit pockets of higher growth

New pathway to China market

Shanghai’s new financially oriented free trade zone may prove a major opportunity for the city to become the financial capital of East Asia. China also hopes to transform Shanghai into a laboratory to restructure the country’s financial sector.

Both property-casualty and health insurers may benefit from the new free trade zone, which covers seaport and airport areas in Shanghai and offers favorable treatment for shipping companies. The increased volume of cargo and overall trade going through the zone will create a greater demand for cargo and liability insurance.

The challenge for insurers will be that the free trade zone is the first to specialize in finance in China. Regulations around the zone are complex, requiring an in-depth review to understand their implications and impact.

ASEAN new market and platform opportunities

A large number of customers and the potential for stronger economic growth in 2014 bode well for insurers in the ASEAN member states. With a population of approximately 600 million, ASEAN countries are expected to see stronger overall GDP growth than mature Asia-Pacific economies in 2014, according to the Asian Development Bank. This growth varies, from 7.7% and 7.5%, in Cambodia and Thailand, respectively, to 3.7% in Singapore.

Trade liberalization is creating new market opportunities in ASEAN countries, but insurers must be cautious about regulatory differences. Twelve new private insurers will enter their first full calendar year of operations in Myanmar in 2014, with large multinational insurers also establishing bases. Now that Cambodia permits foreign market entry, European insurers have established a presence. Insurers are advised to carefully consider their strategic rationale for entering new markets, as it is likely to take considerable effort and time for operations to grow and become profitable.
The more developed ASEAN economies of Singapore, Malaysia, Indonesia and Thailand will continue to attract insurer interest. In Singapore, the Monetary Authority of Singapore (MAS) has stated that it will continue to work with insurers to enhance specialty and reinsurance underwriting and broking capabilities. MAS also will assist insurers to expand their regional hubs and promote growth in emerging business lines like cyber risk insurance. Significant merger and acquisition (M&A) activity in Malaysia has led insurers to begin reinventing their business models. It will be interesting to see how the market reacts to these changes. Similarly, there is high interest in M&A opportunities, organic growth and operational improvements.

In 2014, insurers should identify and develop new market and platform opportunities, consider potential entry points in ASEAN countries or expand further into subregions.

**Develop digital distribution strategies**

Asia-Pacific accounts for 42% of the world’s internet users. Empowered insurance consumers rely on the web to research and buy insurance products. The use of aggregator websites increased 44% and 50% for motor insurance and home insurance, respectively, between July 2012 and April 2013. In India, the market for online life insurance is expected to increase from approximately INR2b in 2013 to INR80b by 2020. And in a recent survey of Japanese customers, 10.5% of respondents chose an online platform as their preferred future service channel, up from 2.9% in 2009.

Online buying trends are increasing insurer competition. Seven Japanese life insurers currently offer direct sales via the internet. In late 2013, as a step toward building a regional internet presence, Lifenet signed an agreement with Kyobo Life Insurance Co. Ltd. to establish an internet-based life insurance joint venture in South Korea. In China, CIRC approved the establishment of a joint venture between a Chinese insurer and two internet companies to sell policies nationwide. Two additional Chinese insurers are working with an e-retailer to sell their insurance products. A major life insurer in Australia decided in 2013 to acquire the remaining 90% of an internet life insurance comparison site to further its online sales growth.
Although technology is changing the way customers engage with insurers, our insurance consumer surveys indicate that personal interactions are still highly regarded. The reasons include the complex nature of insurance products and customers’ continuing need for advice. While digital distribution is growing within Asia-Pacific, insurers in 2014 will continue to rely on agents as the primary sales channel.

To improve customer experience, insurers need to provide more comprehensive support and training to distributors. They also need to better align their administrative systems with distributors’ back offices, streamlining application processing and improving other areas of customer service.

Mobile technology platforms are another prudent investment. Our global survey, *Insurance and digital: the time is now*, highlighted that Asian insurers are far more likely than their global peers to have mobile strategies for intermediaries. For example, one Japanese insurer in 2013 distributed more than 30,000 Windows-based tablets to its sales force to enhance communication between agents and customers. This helped streamline contract processing and led to a more paperless operation.

**Get ahead of regulatory developments**

As insurance regulations in Asia-Pacific increase in number and complexity, insurers must adopt the principles underlying these regulatory developments, such as solvency management, risk management and customer protection. This is good business practice and should be a part of insurer DNA throughout the organization.

**Solvency requirements**

The rigorous solvency requirements that are unfolding across the region will strengthen the industry’s collective financial stability. For example, Singapore, which is generally considered to have one of the more advanced regulatory schemes in Asia-Pacific, is expected to implement second-generation risk-based capital (RBC) regulations in 2014. Hong Kong, which has traditionally allowed insurers a high degree of freedom, in line with its free-market principles, also is expected to strengthen regulation. New RBC standards are likely to be implemented by 2016 or 2017.
Other countries are moving closer to a three-pillar Solvency II-style approach. For example, China’s second generation insurance solvency regulatory regime, which is to be implemented by 2016, follows Solvency II’s three pillars of quantitative capital requirements, qualitative controls and reporting/market discipline. Thailand, which introduced RBC recently, is now considering its second generation RBC requirements. And in the emerging markets in the region, countries like Myanmar are just beginning to grant operating licenses to insurers.

Higher capital requirements in several countries in the region, such as Indonesia and Sri Lanka, have compelled smaller, less capitalized insurers to consolidate, fueling the interest of global insurers to acquire these smaller carriers.

Although insurers will need to dedicate more capital and talent resources to comply with the stronger solvency standards in the region, such investments will create stronger insurers and a more financially sound industry.

**Risk management initiatives**

Growing regulatory pressures to improve risk management are being driven by the influence of the International Association of Insurance Supervisors (IAIS) on local regulators. Recognizing the benchmarks set by the Own Risk and Solvency Assessment (ORSA) in Pillar 2 of Solvency II is another factor. Strong risk management is a critical business practice for companies engaged in assuming risk. While some duplication may result from regulators’ enterprise risk management (ERM) schemes and insurers’ ERM processes, insurers that adopt risk management as a discipline will gain a competitive advantage.

IAIS has introduced a set of practices for ERM, including an ORSA requirement. This framework requires insurers to properly evaluate the amount of capital associated with risk levels. Insurance regulators in Malaysia, Singapore and Australia have introduced ERM standards with an ORSA requirement. In some jurisdictions, regulators have adopted the term internal capital adequacy assessment process (ICAAP), which is common in the banking sector. Both ORSA and ICAAP require the submission of written reports documenting insurer risk and capital profiles.
Insurers that embrace the principles behind ORSA to gain new insights into their risk exposures are in a sound position to identify and pursue a forward-looking approach. This may include changes to product pricing, reinsurance strategies and portfolio management.

**Global systemically important insurers**

In 2013, Ping An was the only Asia-Pacific insurer out of nine globally to be designated as a global systemically important insurer (G-SII) by the G-20 Financial Stability Board. Designation as a G-SII subjects an insurer to heightened group-wide supervision, additional capital requirements, recovery and resolution plans, and increased reporting requirements, all of which add cost. The potential for additional designees in the region is a concern, as is the possibility that the G-SII regulation will be applied at the national level. This trend is evident in the banking sector and has the potential to transcend into insurance.

IAIS has adopted a three-tier structure of insurance supervision, with G-SII requirements at the highest level and insurance core principles (ICPs) at the lowest level. At the intermediate level, IAIS intends to issue further standards for internationally active groups, including capital adequacy standards. These second-tier standards will include many more Asia-Pacific insurers and may also become a benchmark for local capital standards.

**Global accounting standards**

As insurers expand their geographic footprint in the region and seek capital from new sources, the ability to provide financial reports and statements to meet global standards will become a necessity. Identifying and understanding these changes will be difficult for insurers and a diversion from their focus on local or regional growth.

The eventual introduction of International Financial Reporting Standards (IFRS 4 Phase II) will require insurers in Asia-Pacific to report how they plan to implement these new accounting and disclosure changes and comment on how they will impact their
organizations. In the case of Solvency II, the development of the new accounting standard for insurance contracts has been much delayed. Now that the comment phase for the revised exposure draft of IFRS 4 Phase II has concluded, discussions and negotiation will likely continue for several years before the exposure draft’s key points are finalized. This includes the presentation of premiums in the income statement, treatment of cash flows and the effect of changes in the discount rate used to measure insurance contract liabilities.

Customer protection

Insurers in the region are improving operational risk management to achieve higher levels of customer satisfaction. Compared with insurers in other regions, those in Asia-Pacific were ranked relatively low in reputation and confidence in our Voice of the customer survey. Agents and insurers pursuing aggressive top-line growth have long been perceived as mis-selling. This was coupled with complaints of poor claims service in the wake of the heavy catastrophe losses in 2011.

Regulators are addressing these concerns by intensifying the focus on customer protection. Examples include Singapore’s implementation of the Financial Advisory Industry Review recommendations, CIRC moving to increase consumer protection and South Korea forming an independent consumer protection agency to monitor claims dispute and sales activities. Other developments include the insurance Regulatory and Development Authority in India tightening regulations on agent commissions and increasing oversight of policyholder protection, and Malaysia issuing a concept paper considering several reforms, including deregulation in some areas and tightening in others.

Compared with insurers in other regions, those in Asia-Pacific were ranked relatively low in reputation and confidence in our Voice of the customer survey.
Implement data analytics for competitive advantage

Big data analytics – the ever-increasing volume of internal data combined with external data from social media and mobile devices – can help insurers gain a deeper understanding of customers and related buying trends. Successful insurers in 2014 will apply data analytics to make more targeted offers to customers in higher-margin segments. Analytics will also help insurers and bancassurers offering other products to identify cross-selling opportunities with these same customers.

Insurers leveraging advanced analytics to diagnose customer retention issues and lapse rates can respond quickly with tactics to remedy these problems. A case in point is an Australian bank that experienced high lapse rates in its life insurance portfolio. The bank reduced this incidence by applying analytics to identify patterns, causes and solutions, guiding a 7% profit improvement within 6 months.

Analytics also can improve the insurer-distributor relationship and underwriting. As producers capture more data digitally at the point of sale, insurers gain a deeper insight into the risk characteristics. This more granular view of insured risk attributes and loss costs can be correlated with premium and loss data to inform pricing platforms and develop better risk-scoring tools.

Other benefits include the detection of anomalous patterns across an array of variables to identify claims leakage caused by fraud. The General Insurance Association of Singapore estimated that the percentage of fraudulent motor claims paid in the country was 20%, a surprisingly high rate since Singapore is widely believed to be one of the least corrupt countries globally. Similar or higher rates have been estimated in other countries.

Successful insurers in 2014 will be those that adopt a comprehensive, cross-functional data analytics strategy across the enterprise, as opposed to more fragmented strategies.
Identify areas for expense reduction

With profit margins under pressure from heated competition and dwindling investment income, insurers in Asia-Pacific must further reduce expenses to preserve profit. The largest expense-reduction gains will be derived from restructuring, process and productivity improvements, outsourcing and offshoring.

The rapid geographic expansion of regional Asia-Pacific insurers has fostered increasingly complex organizational structures and operational models. Companies with multiple profit centers and broad geographic scope often are undermined by redundancy and duplication of efforts. Obviously, more streamlined operations and simpler organizational structures are necessary to improve efficiency. Insurers can accomplish this by taking advantage of regional platforms and hub arrangements and implementing shared services. An example is Generali's consolidation of operations in several Asian countries into a centrally managed unit. Insurers can also reduce distribution platform costs by combining agency support systems into a single infrastructure and restructuring their bancassurance sales forces.

Moreover, insurers are trimming expenses by implementing straight-through processing to reduce duplicate data entry across functional systems. A recent survey of global insurance IT spending by Celent indicates that Asia-Pacific insurers are implementing IT solutions to increase operational efficiency and are expected to increase their IT spend by 11.5% from 2013 to 2015.

Outsourcing and offshoring also contribute to expense savings. IDC forecasts that the Australian business process outsourcing (BPO) market will grow at a 5-year combined annual growth rate of 6.1%, and new offshoring options have emerged in the Philippines and China. Insurers that recommend and implement a business case for outsourcing or a shared services delivery model can achieve targeted cost reductions.

Conclusion

In 2014, the forces of change and the challenges and opportunities they create will require insurers to determine how to achieve profitable growth and best position their organizations to remain viable. Insurers will need to rapidly execute decisions and refine strategies to pursue the many opportunities in Asia-Pacific.
Canadian life

Encouraging signs, but will insurers seize opportunities?
Market summary

The 2014 Canadian life insurance market is expected to build upon the positive economic factors that appeared in 2013. To seize opportunity, successful insurers need to leverage the operational flexibility they’ve developed over the last few years. Innovative improvements to internal operational fundamentals are essential. But those life insurers that positioned themselves purely for operational survival during the global downturn may be slow to react to this improving economic climate.

In 2014, life insurers must continue to closely monitor interest rates and the equity markets, as well as the ongoing economic recovery in employment, housing markets, consumer confidence and personal wealth. Some markets like the US are showing signs of recovery. But in Canada, interest rates remain low, though steady, and equity markets have grown at a slower pace compared to the US.

Canadian employment and the country’s housing market remained relatively robust throughout the downturn, contributing to higher consumer confidence than in other economies. These conditions helped Canadian life insurers react quickly to the downturn through de-risking and re-pricing programs, and their more recent rebalancing of product offerings has helped to address evolving customer needs. Insurance consumers are more empowered today, thanks to advances in technology and communications, including faster access to informative product data and market information.

Successful life insurance companies – those with strong, comfortable capital positions and improved internal operating fundamentals – should take advantage of this changing environment and return to a growth strategy. To do so, they will need to address changing demographics and customer needs. This, in turn, requires improvements in data analytics to deliver the right product at the right time through the right channels to the right customers. By relinquishing legacy systems that hamper growth and investing in increasingly sophisticated technology and data analysis techniques, insurers can streamline operations and improve their value proposition.

Upcoming regulatory and accounting changes also require insurers to invest in new technologies and related methodologies, processes and people. New regulations address insurer risk analysis, distribution oversight and information transparency. While investments in technology add significant complexity and risk to the business, the rewards should be significant.

To successfully position for growth in 2014, Canadian life insurers will need to achieve the following:

- Maximize return on market improvement
- Harness the power of digital technology and big data
- Address changes in the consumer demographic landscape
- Position the business for regulatory and accounting change
While the improved global market performance in the first half of 2013 offered hope for an economic recovery, volatile economic conditions in Canada persist. Given the uncertain climate, the Bank of Canada indicated in October 2013 that interest rates would remain unchanged in the near future.

Similar pronouncements were made in the US, a market representing a significant portion of the fixed-income investments in Canadian life insurers’ investment portfolios. The Federal Reserve also reaffirmed plans in October 2013 to continue quantitative easing, dimming prospects for higher interest rates south of the border, as well. Although economic activity has improved, the Fed has stated that it will “proceed cautiously” in decreasing its assets purchases in 2014.

In Europe, a different story is in play: waning growth and inflation are pressuring the European Central Bank to cut interest rates to preserve the current economic recovery. However, with rates already at historic lows, the Bank’s options are limited. Factors such as unemployment, austerity programs (to reduce budget deficits and sovereign debt) and the rising euro are contributing to the eroding investment propositions in several European countries.

Insurers realize their business strategies must effectively take into account the continuing low interest rate environment. Although the long-term expectation is for interest rates to rise, life insurers must make timely decisions that address the current subpar yield conditions.

The key challenge for insurers continues to be their limited ability to reduce interest rate risks for savings- and investment-oriented products. Most insurers in recent years have reviewed their existing product portfolios to reprice or eliminate their high-risk, capital-intensive and low-margin products, while also seeking profitable ways to maintain or gain scale. On the asset side, many insurers continue to contemplate increasing risk in their asset portfolios as a way to obtain higher yield.

The renewed focus on asset management and wealth management (and less interest in costly and risky guarantees) compels life insurers to develop more innovative, attractive products. Companies must continue such innovative pursuits to improve profitability in areas such as tax strategies, sales force management and asset liability management.

The increase in equity and credit market volatility over the past few years is another front-burner issue. It is now clear that these risks were not well understood or priced appropriately prior to the financial downturn. The income from products involving asset-based management fees has been unstable, causing earnings to decline at a time when hedging programs are less effective and more expensive. Consequently, the industry must decrease its risk exposure while enhancing product and service features that appeal to consumers.
To allow for these product adjustments, most insurers have made the following changes:

- Increasing the fees on variable products to reflect the cost of hedging in the volatile economy
- Restricting investments that limit the amount of risk assumed by customers
- Implementing automatic rebalancing to protect customers from significant asset value movement, which also stabilizes the insurer’s fee income

These various product-oriented techniques help limit the exposure to an insurer’s capital and economic position while providing the services that customers expect, i.e., bearing the risks they are unable to bear. By reducing volatility for customers – and insurers – they have been well-received.

By marketing simpler, flexible products with clearer, comprehensible value propositions, and by removing product characteristics that buyers dislike, insurers can effectively grow the top line. For instance, whole life insurance and term life insurance continue to be popular with consumers because of their easy-to-understand, straightforward value propositions. On the other hand, participating products are attractive from an insurer’s perspective, while providing customers with the potential for upside risk.

Harness the power of digital technology and big data

Digital technology offers insurers the profound ability to improve underwriting, sustainably reduce costs, enhance customer experience, create novel marketing strategies and analyze consumer behavior.

While many insurers are improving expense management through outsourcing, focusing more diligently on core businesses, streamlining existing processes and increasing overall automation, they have not made the more difficult investments in how they operate. In other words, they continue to use legacy systems that require significant resources to operate, rather than implementing enterprise-wide digital technologies.

Legacy systems lack the flexibility to provide the evolving business and regulatory information that insurers must have to address their strategic, operational and compliance responsibilities. Despite continuing cost reductions, insurers must review their current digital technology capabilities with an eye toward further investments.
Digital technology offers insurers the profound ability to improve underwriting, sustainably reduce costs, enhance customer experience, create novel marketing strategies and analyze consumer behavior.

For the most part, Canadian insurers have resisted these investments in technological enhancements, leery of the upfront costs and potential risks. The EY Global Insurance Digital Survey 2013, Insurance in a digital world: the time is now, indicates that 68% of insurers believe their internal company culture is the key challenge impeding their digital agenda.

By leveraging predictive modeling and consumer analytics, insurers can speed up the underwriting process, resulting in lower costs, faster policy issuance and potentially greater sales. Predictive modeling also decreases sales and marketing expenses by pinpointing those individuals most likely to purchase products. It further facilitates more targeted risk selection, which improves underwriting performance.

Other areas of opportunity include cloud computing, a more scalable, lower-cost alternative to traditional IT delivery methods; mobility; and social networking. Insurers in Canada and around the world have been slow to adopt mobile and social networking strategies. With younger customers increasingly using mobile devices and social platforms to research and buy products, it is critical for insurers to invest in these areas. Once they make such investments, they must also determine how to leverage the resulting data to better build and distribute products, as well as more effectively manage customer relationships over the relevant lifecycle.

All opportunities invite complexities, of course. A keen understanding of cyber risks and data privacy matters is a necessary part of the due diligence into these investments. The Office of the Superintendent of Financial Institutions (OSFI) has heightened its focus on future technology risks and is working with the industry to help develop greater awareness understanding and preparedness. It is critical that companies weigh the potential risks arising from technology enhancements and manage them accordingly.

Digital technology is now a business reality – and it’s here to stay. Other industries have been quicker to adapt and are now competing on a different playing field. Insurers in Canada are currently not ready to compete with these changes. Those insurers that make the necessary investment now will likely be the ones that come out on top in the long run.

**Address changes in the consumer demographic landscape**

The life insurance business is built on demographics. Over the past several decades, Canadian life expectancy has increased, spurred by advancements in preventive and curative medical treatments. At the same time, health care expenditure per capita has risen to $4,519.96 in 2011 from $2,519.13 in 2000, and $2,054.13 in 1995, according to the World Bank. As the need for health care insurance solutions increases further, insurers may want to develop new products or add benefits or riders to existing products.

Understanding changing demographics will have a significant influence on Canadian life insurers’ ability to capitalize on market opportunities. For example, Canada will experience a significant wave of retiring baby boomers over the next several years. This represents a significant opportunity for product innovation – insurers should look to post-retirement product needs, hybrid products and products for working retirees.
Of course, insurers must capitalize on the risk transfer and savings needs of people of all ages, from the young to pre-retirees and retirees. As insurers address the product needs of the younger, more technologically savvy consumer demographic, product innovation is critical. Products such as term life insurance and whole life insurance will continue to generate interest among younger consumers because they are simpler and easier to understand. Such products also can be purchased easily through digital technology.

These features contrast with more complex retirement savings and insurance products, purchased by individuals who today are retired or near retirement, and who prefer to deal directly with agents. And they differ from the products targeting high-net-worth individuals and mass-affluent segments, which include repriced variable annuities, an expanding line of indexed and deferred income annuities, and life insurance products targeting estate-planning needs.

Insurers also must look to expand growth opportunities beyond the wealthier demographics. Developing cost-effective ways to distribute to the mass market will differentiate successful insurers from the rest of the marketplace. This requires insurers to operate efficiently and segment the market effectively, responding to the growing demographic, socioeconomic and digital diversity of potential mass-market consumers.

But the continuing success of the wealth management arms of certain insurance companies cannot be ignored. While these products represent a conscious move away from protection and risk transfer, they have proven to be simpler for customers to understand, and they continue to generate sales in Canada and worldwide. Because such products lend themselves more easily to the use of technology, they represent an area where insurance companies can level the digital playing field with the larger banks.

**Position the business for regulatory and accounting change**

More stringent regulatory and accounting changes continue in 2014. OSFI issued proposed regulations addressing diverse issues, from governance and risk to cybersecurity. Solvency and capital direction also remain regulatory challenges, while newly emerging financial reporting standards may adversely affect business models, operations and capital levels. On the provincial front, regulators are especially active in areas such as insurance distribution and managing general agent (MGA) licensing and regulation. Securities regulators, on the other hand, continue to scrutinize insurer financial reporting and public disclosure, and they are demanding much less complexity and more transparency in these regards.

At the global level, the Financial Stability Board designated nine international insurers as global systemically important insurers (G-SIIs) during 2013. While no Canadian-based life insurers were included in these designations, this is an area that larger insurance companies in Canada should continue to monitor. Such designations would increase demands on insurer resources and capital requirements. They also may create a competitive advantage for designated insurers, by implying the security of an implicit government backstop.
More stringent regulatory and accounting changes continue in 2014. OSFI issued proposed regulations addressing diverse issues, from governance and risk to cybersecurity.

The International Association of Insurance Supervisors (IAIS) is putting the final touches to its Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), a set of international supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups (IAIGs). The requirements are expected to be field-tested in 2014 and issued in 2018. IAIS also plans to develop a risk-based global insurance capital standard by the end of 2016. Full implementation is scheduled to begin in 2019, after two years of testing and refinement with supervisors and IAIGs.

In 2013, OSFI issued its final Corporate Governance Guideline, which applies to all federally regulated financial institutions (FRFIs) other than the branch operations of foreign banks and foreign insurance companies. The guideline is predicated on enhancing the effectiveness of boards of directors by providing clarity around board responsibilities. It also seeks to strengthen the risk governance of FRFIs by requiring the development of a "risk appetite framework" to guide the institutions' risk-taking activities. Another goal is improving the overall internal control framework of FRFIs by clarifying the roles of the chief risk officer and the audit committee. FRFIs must have completed and submitted a self-assessment and action plan to OSFI by May 2013. Full implementation of the guideline is expected no later than the end of January 2014.

That same month is expected to see a final version of OSFI's Own Risk and Solvency Assessment (ORSA) draft from 2012. The requirements are similar to those seen under Solvency II in the European Union and ORSA requirements issued by the National Association of Insurance Commissioners (NAIC) in the US.

While Solvency II and the NAIC's requirements are expected to become effective in 2016 and 2015, respectively, insurers in Canada will start reporting to OSFI on the ORSA initiative in 2014. While the new guideline is not predicted to cause a major shift in business focus, it will likely increase insurer understanding of exposures, compelling a range of decisions. If the initiative increases the cost of regulatory compliance, this may compel smaller insurers to consolidate to maintain their competitive edge.

In October 2013, OSFI issued the Cyber Security Self-Assessment Guidance, applicable to all financial institutions in Canada. The increasing frequency and sophistication of online attacks has raised the risk profile of key organizations, resulting in a clear increase in scrutiny by public and other stakeholders.
As such, OSFI required FRFIs to conduct a self-assessment focusing on six key areas:

- Organization and resources
- Cyber risk and control assessment
- Situational awareness
- Threat and vulnerability risk management
- Cybersecurity incident management
- Cybersecurity governance

The self-assessment is expected to be ongoing, and OSFI has no plan to establish specific guidance.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board both issued revised accounting standards exposure drafts on insurance contracts in 2013. Each involves new approaches to balance sheet and income statement presentation of insurance and insurance-like guarantees, under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles, respectively.

For Canadian life insurers, the valuation model proposed under IFRS shares similarities with the Canadian Asset Liability Method, currently used for the valuation of actuarial liabilities. While IASB made significant changes to the proposed model in its initial 2010 exposure draft, as a result of feedback from the insurance industry, important issues of concern for Canadian life insurers remain. These include discount rates, comprehensive income accounting and complexity of application. The final standard is expected by the end of 2014 or shortly thereafter, with an effective date likely to be in January 2018.

These various regulations generally compel insurers to improve their modeling capabilities, data quality, data governance, and the level of detail provided by their reporting and modeling systems. Canadian life insurers will need to analyze the impact of these changes on profitability and products, making sure that their systems, people and data are prepared and capable of implementing the new requirements.

**Looking ahead**

If the Canadian economy starts to show the same signs of improvement as the US economy in 2014, life insurers will need to think and act quickly to adapt to the new reality. Technological, demographic and regulatory changes mean that old ways of thinking and serving customers need to be revisited if Canadian insurers are going to be able to seize opportunities and set themselves apart from the competition.
Europe
Unlock new opportunities, simplify existing operations
In 2014, growth potential for European insurers will rise as, and if, their economies recover from the recent economic crisis and recessions. Recovery is by no means assured. Third-quarter GDP growth was just 0.1% and potential relapse into another recession is not out of the question. The strength of recovery will continue to vary by country, reflecting macroeconomic factors within each subregion. Throughout Europe, this relatively slow economic growth and continued low interest rate environment is pressuring insurers as they seek paths to profitable growth, challenging existing business models, insurer investment strategies, product mix, business processes and operating structures.

A prolonged low interest rate environment poses a major threat to existing business models of life insurers by reducing investment income and squeezing product margins. This is encouraging European life insurers to continue to identify the potential for restructuring and simplification in order to drive out cost and streamline operations. As insurers watch investment returns dwindle from the impact of low interest rates, they will adjust portfolios and seek to increase yield without taking on significant added risk, most noticeably by seeking new diversification effects. The risk-return trade-off is, however, an important consideration, and as insurers gravitate to real estate, infrastructure and other alternative classes, they must manage risk to avert the errors of the recent past.

Offsetting lower investment returns are continued opportunities for growth stemming from the demographic realities of an aging Europe and improving middle class opportunities in some pockets. Improving economic conditions in some regions are likely to bring higher motor and home sales and stimulate more business formation. At the same time, the large loss potential stemming from the growing severity of natural catastrophe events in the region adds to consumer and business demand for financial protection. Despite the increased threat to businesses, the cyber liability market is still relatively immature in Europe and represents a meaningful opportunity for growth.
## Market summary

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In 2014, European consumers will be increasingly digital, especially through their expanding use of mobile devices. However, EY’s global survey, *Insurance in a digital world: the time is now*, published in 2013, found that an overwhelming majority – 84% of insurers – currently spend less than 10% of their IT development budget on digital. Leading companies will be increasing their investment to reach consumers through digital media.

The proliferation of data and analytics to draw meaningful insights from data is revolutionizing parts of the insurance sector, pushing some insurers to create a comprehensive platform to receive, store and exploit the insights from sound analysis of data. Virtually all functional areas of European insurers – from customer targeting to product design and pricing, to agency management, underwriting, claims and reporting – can be improved with architecture and analytic processes making efficient use of data.

Regulations at the national, European and global levels continue to influence strategies, investments and capital requirements. EY’s 2013 survey of global insurance executives, *Business Pulse: exploring dual perspectives on the top 10 risks and opportunities in 2013 and beyond*, makes clear that insurers need to adjust to stricter regulation on everything from capital requirements to commission rates and customer care. The successful conclusion of the Omnibus II Directive negotiations provides clarity over the long- awaited Solvency II implementation timeline delay until January 2016; as a result, other regulatory changes are moving to the forefront.

While these and many trends will be similar for European insurers in 2014, there are some issues that are more specific to the separate Eurozone and UK markets.

**Eurozone focus: a slower economic recovery and low interest rates**

Economic growth in the Eurozone region in 2014 will help improve business results and increase nominal disposable income, but may not be strong enough to reduce unemployment. Nevertheless, Eurozone life and non-life insurance premium growth is forecast to increase modestly in 2014. Demand for retirement products will rise with increasing personal income and consumer wealth, with 20% of the Eurozone’s population over 65 and an increasing number approaching retirement every year. Awareness of the exposure to financial damage caused by natural catastrophes will increase interest in protection products, after particularly severe floods and winter storms in 2013.

While increased premium growth will be welcome news, low interest rates will remain a particular challenge for Eurozone life companies as they try to reconcile investment guarantees with current asset yields. This issue is particularly acute in Germany, where the proportion of insurance sold with guarantees is higher than in many other European markets. Persistently low interest rates will also raise the cost of providing term products.
UK focus: stronger economic growth, low interest rates and adjustments to distribution

Turning to the UK specifically, business confidence will continue to improve in 2014 and firms will take advantage of low borrowing costs and strong liquidity. This will lead to stronger economic growth than in the Eurozone. UK unemployment is expected to decrease slightly, while nominal personal disposable income is expected to increase slightly.

As in the Eurozone, the aging UK population offers insurers opportunities to provide a variety of products to help older consumers meet their financial challenges, and we anticipate continuing innovation in this space. But reaching consumers to generate this premium increase will continue to be challenging in 2014.

In addition to EU-level regulations, UK insurers continue to face an evolving regulatory landscape. The Financial Conduct Authority’s (FCA) thematic reviews (e.g., dual pricing and ancillary sales) may challenge many firms’ current business models. The Prudential Regulation Authority (PRA) is focused on insurer risk management and solvency. The Sergeant Review of Simple Financial Products provided guidelines and recommendations that UK insurers and financial product providers should follow to introduce more consumer-friendly life insurance and savings products. Given the high proportion of non-life premium in the London market that originates from the US, the introduction of the Foreign Account Tax Compliance Act (FATCA) has created significant challenges.

In the post-Retail Distribution Review (RDR) environment, where commissions are banned on investment business and fees have to be paid for advice, the number of distributors will continue to shrink, as financial advisors and banks struggle to engage mass market customers profitably. In 2010, there were approximately 28,000 advisors in the UK; EY estimates that number will have fallen to 20,000 in 2014. However, online life distribution platforms will continue their comparatively strong growth into 2014, as consumers opt for self-service rather than fees.

In general insurance, the intense motor sector price competition from aggregators will continue and will limit insurers’ ability to raise rates to levels appropriate for this margin-challenged line. The FCA is studying add-on pricing, competition and selling practices, raising the potential that add-ons to basic policies are likely to come under increasing regulatory and customer scrutiny during the year. Additional pressure for UK personal lines insurers will come from new caps on household flood insurance premiums for flood-prone areas, along with an industry levy, exacerbating falling home insurance rates.
Successful insurers in Europe in 2014 will:

1. Restructure and simplify the organization
2. Keep pace on the regulatory treadmill
3. Target key customer segments with innovative, profitable products
4. Retool their investment strategy
5. Develop digital platforms to reach connected consumers
6. Seize the potential of data and advanced analytics
7. Respond to regulatory changes in distribution and markets

1. Restructure and simplify the organization

In 2014, European insurers will need to simplify, restructure and alter their business models. Successful insurers will be those that restructure and simplify their organizations to create more efficient operations that can take advantage of emerging growth opportunities.

A prolonged low interest rate environment poses a major threat to the existing business models of European life insurers, reducing their investment income and squeezing product margins. To survive in this environment, life insurers need to restructure their product portfolios. With balance sheets under extraordinary stress from guaranteed product obligations, the spread compression is driving insurers to focus on unit-linked products, whereby more risk is transferred to policyholders. A recent Linklaters survey of European life insurers reveals that 62% had redesigned their products to reduce benefits to policyholders. If interest rate conditions persist, more insurers will follow suit, with 56% of insurer respondents stating they will be compelled to radically overhaul their business models. Almost half the respondents issued concerns that Europe may cease to be a viable life insurance market.

1 Life changing: the outlook for life insurance companies in Europe, Linklaters, 2013.
Successful insurers will be those that restructure and simplify their organizations to create more efficient operations that can take advantage of emerging growth opportunities.

The limited organic growth opportunities and diminishing investment returns also oblige European insurers to correct management structures and simplify decision-making processes. Another strategic priority in 2014 is cost reductions to improve margins and operating results, although, paradoxically, insurers may need to invest further in system overhauls and upgrades. In this regard, insurers need to examine the prudence of developing entirely new systems versus laying new applications on top of legacy systems. The need for new systems is particularly acute in the claims area, where multiple systems for claims are incapable of receiving the increasing volume and variety of data – the so-called big data phenomenon.

In the quest for additional sources of value creation, many European insurers are restructuring their reinsurance buying strategies to achieve cost savings through the purchase of fewer, more consolidated treaties. Competitive pressures from burgeoning capital market alternatives have compelled leading reinsurers to offer more generous terms to cedents, including expanded coverages, multiyear contracts and the removal of specific exclusions and loss ratio caps.

Restructuring also is evident, with some Continental European insurers putting their life insurance books of business into runoff to release trapped capital. These reactions are a response to Solvency II dictates. In the UK, Celent identified that 39.6% of premiums for life, annuities and pensions were from non-strategic or closed books. The move to allocate capital away from both legacy life and non-life books of business is boosting the European runoff market, which grew by 5% in 2013 to €235b (US$318b). Some European insurers are reallocating this capital toward higher growth market opportunities in Asia and Latin America.
2. Keep pace on the regulatory treadmill

EY’s 2013 Business Pulse survey makes clear that insurers need to adjust to stricter regulations on everything from capital requirements to commission rates and customer care.

The long-awaited agreement on Omnibus II, and certainty regarding its implementation date (1 January 2016), returns Solvency II to the forefront of the regulatory agenda. With agreement on Omnibus II, there is now a clear deadline for achieving Solvency II compliance in 2016. As other global and European regulatory requirements beckon, European insurers must maintain pace with this regulatory treadmill, or risk falling behind and having to spend extra effort and expense to catch up in the future.

As insurers keep pace, 2014 will be a big year for them to complete their model development, documentation and validation to support their applications for internal model approval. The short timelines added to the regulatory complexity will strain insurer resources. Companies should consider taking a holistic approach to these changes, rather than a piecemeal approach, permitting more comprehensive responses that reduce costs and duplication.

Insurers also must ensure their processes and systems are ready for Solvency II’s transitional reporting period (2014–15) and final implementation in 2016. Methods to report interim quantitative reporting templates (QRTs) prove the existence of an effective risk management system and verify that the forward-looking assessment of “own” risks are needed. The challenge is determining if more permanent solutions rather than shorter-term and manual solutions are best to meet the rapidly approaching transitional requirements and full implementation by 2016.

Other regulations coming to the forefront include the global systemically important insurer (GSII) designation, which touched only a few European insurers in 2013. Nevertheless, insurers need to bolster their awareness of the efforts by local regulators to place insurers of national importance under closer scrutiny. At the same time, insurers face numerous other regulations from the EU, such as MiFID II (Markets in Financial Instruments Directive II), PRIPs (packaged retail investment products) and IMD 2 (Insurance Mediation Directive 2), affecting everything from distribution to product disclosure and investments. Insurers across the EU will need to evaluate the framework and functions of their existing compliance models to ensure they remain fit for purpose.
Although the EU Draft Directive on Financial Transaction Tax is also set for implementation in 2014, not all governmental bodies are in agreement as to the shape and scope of the tax, requiring continuing insurer interactions with Brussels and national governments to stay on top of the issue. In the interim, insurers need to evaluate how these tax changes may affect business operations and plan accordingly. While the full impact remains uncertain, insurers are expected to develop systems for the identification, collection, reporting, registration and accounting of the tax.

The EU is not the only source of regulatory concern. Regulations in the US, such as the Dodd-Frank legislation and FATCA, in addition to solvency and compliance regulations in Asia-Pacific, require the attention of European insurers operating beyond local borders. Insurers need to consider how best to incorporate these external regulations in their comprehensive response to regulatory change.

With the comment period on the revised Exposure Draft of International Financial Reporting Standards (IFRS) 4 Phase II now closed, the industry in 2014 must pay close attention to whether or not the International Accounting Standards Board (IASB) will issue the final standard in early 2015, as planned. Combined with IFRS 9, the operational and practical implications of IFRS 4 Phase II are significant. In 2014, insurers will need to assess these accounting and reporting changes to ensure they understand the synergies that can be leveraged from Solvency II reporting and additional reporting requirements in the future.

In the UK, insurers have the added challenge of implementing Financial Reporting Standard 102, which effectively replaces current UK generally accepted accounting principles (GAAP) in 2015. UK insurers continue to face an evolving regulatory landscape. The FCA’s thematic reviews (e.g., dual pricing and ancillary sales) also challenge many firms’ current business models, while the PRA is focused on insurer risk management and solvency. Other pressures include the Sergeant Review of Simple Financial Products, which provides guidelines on the introduction of consumer-friendly life insurance and savings products.
3. Target key customer segments with innovative, profitable products

As the Eurozone and UK continue to recover from the recent economic turmoil, European insurers have an opportunity in 2014 to increase sales by targeting two customer segments – the region’s aging population and the personal and commercial non-life markets. Insurers still must maintain focus on profitability to fully realize the benefit of higher sales.

A 4% increase in the number of individuals aged 65 years or older in the EU is forecast for 2014, at a time when austerity efforts continue to contract the social safety net. The lower level of social support increases the need for retirement income, health and long-term care products and advice. Some older individuals with the financial means are more likely to travel, increasing potential sales of travel insurance. These opportunities vary based on local demographic and regulatory conditions, requiring insurers to evaluate which areas offer the greatest opportunity for growth.

As consumer wealth improves, so does the demand for cars and other goods. Sales of cars in Germany have stabilized and are expected to increase in 2014, according to the German Automobile Federation. Spain, Portugal and Greece recorded double-digit increases in new vehicle registrations, translating into higher sales of motor and other non-life coverages. Meanwhile, £300m (US$494m) in storm losses in 2013 in the UK, and €3b (US$4b) to €6b (US$8b) from the central Europe flood damage caused in 2013, have increased consumer and business awareness of the need for property and business interruption insurance. Similarly, news of data breaches and identity theft events has raised concerns about commercial and personal cyber risks, creating a growing market for these products.

As growth conditions improve, successful insurers will be disciplined about their bottom-line profitability and capital allocations. As Europe’s consumers become more confident about their personal financial situations, and are able to purchase more insurance due to the improving economic conditions, insurers may eventually engage in pricing wars to spur top-line sales growth. Evidence of lower prices and other efforts to gain market share is apparent in the motor insurance markets in some countries. For non-life insurers, the growing use of aggregator sites adds further pressure on pricing. Low interest rates also pressure insurer investment spreads, affecting the profitability of some life products. As a result, insurers face another year when profitability may prove difficult to achieve.
4. Retool their investment strategy

Recognition that the low interest environment may persist in 2014 increases the imperative for all insurers to take actions to reshape their investment allocation strategy. In this effort, insurers must pursue strategies to increase investment yields, and be clear that they are being compensated for any increase in risk that is added to the portfolio. They also must take into account the risk correlations that may emerge among different asset classes, as well as the correlations that may exist between asset and liability exposures in changing economic environments.

Successful insurers in 2014 will pursue multi-asset strategies that include higher-yielding alternatives, hedging and stress testing these strategies to minimize risk from adverse scenarios. Macro hedging can reduce currency and other forms of volatility, as well as manage strategic positions at both the group and operating company levels. Stress testing can reveal key vulnerabilities in the investment portfolio from severe event and risk factors weakening solvency positions. Although most stress tests evaluate single factor shocks, such as sovereign risk, liquidity risk and interest rate changes, comprehensive stress testing contemplates concurrent stressor and contagion effects.

The search for higher yield suggests that European insurers will continue to shed their exposure to sovereign debt and other classes perceived as bearing higher risk, such as bank debt. They are also likely to reduce their holdings of high-grade fixed income debt, shifting assets to classes deemed higher yield at no additional risk. In the UK, insurers are reducing their positions in such safe havens as bond and money market funds.

European insurers also seek ways to generate incremental returns through strategic diversification, which should yield benefits under Solvency II. For example, if an insurer were to replace some fixed income investments (at a 20% capital charge) with real estate investments (at a 25% capital charge), the diversification credit would reduce the overall capital requirement, even though the insurer has moved into a class requiring a higher capital charge.

Insurers will increasingly apply robust economic scenario tests of the interaction between asset classes and liabilities, including considerations of policyholder behaviors and competitive environments. By changing their investment portfolio positions, this may either mitigate or exacerbate insurers’ enterprise risk and returns, in directions that may differ from the pure economics of the investment class.
As the European economy improves, insurers are expected to develop a stronger digital presence to reach connected consumers. Investments in digital channels will address the increasing service expectations of consumers purchasing insurance on the internet. Social media, for instance, empowers consumers to share their service experiences to friends and acquaintances. A recent EY survey, *Protecting and strengthening your brand: social media governance and strategy*, conducted in the UK, reveals that 80% of social media users connect with friends and family in rating products and services.

The development of digital platforms is an essential success factor in 2014. At present, the overwhelming majority of insurers (84%) spend less than 10% of their IT development budget on digital initiatives, according to EY’s global survey, *Insurance in a digital world: the time is now*. On the bright side, the survey indicates that 37% of the European insurer respondents expect a more than 50% increase in their spending on digital development in the next five years, much higher than the 24% increase in these plans globally over the same period.

With fewer distributors due to regulatory changes, a digital platform can satisfy the technological needs of the distributors that remain. The enactment of stringent commission and distribution model changes in the UK and the Netherlands, and implementation of PRIIPS and similar regulations in the Eurozone, focus distributors more on servicing higher-net worth insurance customers than middle-market consumers. As a result, insurers have the opportunity to reach these “abandoned” customers by developing digital platforms providing financial advice and online purchasing. Nearly 50% of European respondents to the EY survey said that “regaining more direct control of the customer relationship” was the key driver in their digital strategy.

As insurers develop digital platforms, they face several challenges, chief among them the cost and complexity of integrating new customer-centric systems with multiple legacy systems. Identifying an appropriate return on the investment in digital will be a key factor in moving forward with such plans in 2014. Finally, as insurers streamline operations to increase customer transparency, they must heighten their data security, given the potential for reputational damage from a data breach involving customers’ personally identifiable information.
6. Seize the potential of data and advanced analytics

European insurers that adopt a comprehensive, cross-functional enterprise data analytics strategy in 2014 are likely to outperform those carriers with more fragmented approaches. Virtually all functional areas, including customer targeting, product design, pricing, agency management, underwriting, claims and reporting, can be improved by more efficient use of data. Advances in predictive modeling, for instance, make possible significant improvement in underwriting and claims processes.

Building an enterprise data platform requires sound data architecture and controls to assure data quality and completeness. In 2014, European insurers need to improve their management of data at all phases of the product delivery spectrum, from front end to back end. As EY’s recent Solvency II benchmark survey indicates, a principal reason why many European insurers are not ready to be Solvency II-compliant is because of data quality management problems.

Since many insurers’ data resides in disparate systems, it must be consolidated into enterprise data to reduce duplicate data entry and access activities. Once this data architecture foundation is built, information can be processed via analytics to yield high-level insights – patterns, anomalies and relationships that guide informed decisions on agency management, business development, underwriting and claims.

Advances in claims-predictive modeling may generate significant margin improvement for insurers, particularly for those first to implement these tools. For instance, data analytics can enhance the discernment of fraudulent claims. An estimate from Accenture2 indicates that European insurers lose approximately €10b (US$14b) annually to fraudulent claims. Claims executives report a rising incidence of fraudulent claims, and weaknesses in their ability to adequately detect fraud. Other claims activities such as settlement management, subrogation optimization and claims benchmarking also can be improved through advanced data analytics.

As predictive analytics are applied to small commercial and larger businesses, the increasing volume of available data can be applied to complex business lines and specialty classes. The rich data on customer behaviors provided by such innovative technologies as telematics also invite opportunities to redefine how products are priced. Down the line, predictive modeling will move the dial closer to the “science” end of the “art versus science” underwriting challenge.

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2 “Fraudulent P&C insurance claims on the rise in Europe, Accenture survey finds,” Accenture, June 2013.
7. Respond to regulatory changes in distribution and markets

In 2014, European insurers will need to address the disruption of their distribution strategies caused by regulations such as PRIIPS, MiFID II, IMD 2 and RDR. RDR has already impacted the UK and Dutch markets with a decrease in the number of investment advisors in the UK, affecting revenue and expenses, and causing many insurers to focus on a higher-net wealth clientele. Local regulatory initiatives also affect insurer distribution networks.

Some UK insurers are responding with alternative methods of providing financial advice to middle-market consumers, such as building platforms that facilitate online transactions. Other insurers are focusing on digital distribution to accomplish the same goal. Insurers can effectively combine traditional and digital distribution methods.

Insurers are adjusting to the growing use of online aggregators and comparison sites, the fastest-growing insurance distribution channel. A Finaccord study\(^3\) indicates that 42.3% of Europeans purchasing car or home insurance for the first time, or switching from their current carrier to a new insurer, undertook these actions online in 2012, up from 35.4% in 2008. Some insurers have adjusted to this reality by purchasing an aggregator.

As insurers make these adjustments, regulatory scrutiny of aggregators is increasing. The European Insurance and Occupational Pensions Authority (EIOPA), in particular, is looking to exert its influence and provide leading practice guidance to comparison websites in the first quarter of 2014. EIOPA has issued concerns about customer overreliance on the price of products rather than the terms and conditions, conflicts of interest due to the close commercial links between insurers and comparison sites, and the suitability of websites for certain types of products.

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\(^3\) Aggregation metrics: consumer approaches to online insurance comparison sites in Europe, Finaccord, January 2013.
Latin America

Significant opportunities and challenges in a highly competitive environment
Market summary

The Latin American region presents rich growth potential to competitively astute multinational and regional insurers in 2014, particularly for companies that pursue specific market niches. Overall, insurance penetration rates still remain low in many Latin American countries, particularly on the life insurance side despite continuing economic growth and reduced poverty levels. Nevertheless, growing risks include significant regulatory and fiscal reform, inflation, substantial catastrophe exposures and volatility in currency exchange rates. Insurers that efficiently manage these complexities, focus intensely on the markets in which they compete and achieve positive changes in their operating environments are highly favored to prosper. These factors may also drive consolidation in the market as larger insurers are potentially better placed to deliver the change required.

An understanding of the external forces at play in the region can help shape strategic and operating priorities. These forces demand increased attention in 2014 and must be prioritized organizationally.

External forces in 2014

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Successful insurers assessing these forces to improve profitability in Latin America in 2014 will seek to:

- Focus on niches with expanding market opportunities
- Respond to competitive environments
- Develop efficient distribution alternatives
- Enhance and embed risk and capital management frameworks
- Develop and support insurance talent
- Advance data quality and precision
Focus on niches with expanding market opportunities

Rich growth opportunities continue to draw insurers to launch operations or expand their presence in Latin American markets. Since 2012, on average, insurance premiums have grown at a double-digit pace across the region, well above the rate of most other global regions. This pace will continue through 2014, compelled by strong regional growth in small business and the modernization of mature industries and infrastructure, which drive demand for insurance protection.

In this heightened competitive environment, insurers can accelerate premium growth by targeting the rapidly growing market clusters within the region. While economic volatility and inefficiencies in Brazil’s infrastructure, for example, have tempered recent enthusiasm to some degree, insurance premiums nonetheless continue to grow at a robust pace. Total direct premium in Brazil increased 14% in 2013, higher than the 10% nominal increase in GNP. Total insurance in Mexico grew at 11% (excluding the impact of a Pemex multiyear property renewal) and is well above the country’s 7.5% nominal GDP. The trend of robust premium growth continues in other Latin American countries: Colombia’s premium growth was 8% in 2013, while total insurance premiums in Peru grew 16%.

This high demand for insurance exceeds Latin America’s overall economic growth. Specific insurance products and market segments with high growth potential include personal lines and especially life insurance, given the improved economic conditions in many countries and the growing need for insurance.

Increasing insurance penetration of the consumer sector is another growth factor, with life insurance emerging as a dominant channel for savings in Brazil. Individual life premiums in the country rose 29% in 2013, following a 66% increase in 2012. In Mexico, individual life premiums were up 23% in 2013, on top of a 19% increase in 2012.

Rising entrepreneurship, the growing small business segment and the expanding global needs of more mature businesses in many regions are propelling significant increases in commercial insurance premiums. In Brazil, these factors contributed to an 18% rise in 2013 in direct premium for Compreensivo Empresarial, a commercial multi-peril insurance product. The Brazilian government supports entrepreneurial growth and has passed special laws and introduced tax breaks for micro-enterprises known as “simples.” Consequently, parts of Brazil’s informal economy are migrating into its more formal economy. Mexico also has built a strong policy framework to support small- and medium-sized businesses, expanding the national loan guarantee program and facilitating more simplified regulations. Colombia has similarly reformed its regulatory processes involving permit applications, taxes and cross-border trading to increase the ease of doing business for small companies.
More mature Latin American companies are poised to expand significantly within Latin America and outside the region. The best of these Multilatina businesses are becoming world-class global leaders in their industries. As they expand globally, they are implementing far-flung global supply chains, which introduce a range of credit, business interruption and other financial exposures. Many Latin American insurers also are structurally part of larger corporate families. These various complexities require more targeted risk management and risk transfer solutions. Additional challenges emerging across the region include currency exchange restriction risks, as seen most acutely in Venezuela. To expand capital market access, Chile, Peru and Colombia are integrating their stock markets.

By targeting high premium growth clusters in smaller markets, insurers can achieve significant growth potential. Peru's steady economic growth and expanding middle class, for instance, have strengthened Peruvian businesses that are now expanding into foreign markets. Middle class consumers, small business development and Multilatina maturity throughout the region offer significantly high near-term growth opportunities for both multinational and regional insurers.

**Respond to competitive environments**

Insurance capacity across the region is expected to continue to increase in 2014. This is especially the case in Brazil, where double-digit decreases in premiums are anticipated across many low-hazard markets. Successful insurers will redouble their efforts to find profitable opportunities in this environment of diminishing premium rate adequacy and reduced margins.

These insurers must not only identify opportunities for superior top line and bottom line growth. They also need to execute effective strategies to better serve these segments relative to their competitors. This requires developing a customer-centric business culture focused on customers' distinctive needs and expectations.

A critical challenge is consumers' general reluctance to purchase insurance products other than those they are mandated to buy by law. In such low penetration market segments, insurers and the industry must build necessary product awareness and instill customer trust. Collaborative endeavors undertaken by industry participants in Latin America are not nearly at the same level of cooperation of North America and Europe. Insurers need to share data capabilities and interact with governments through trade associations to achieve positive regulatory change, while obstructing more burdensome regulations. A vibrant insurance marketplace with robust risk protection for growing consumer and business economies requires stronger industry and government and private and public partnerships.
Insurers also must tailor their products to the cultural expectations and economic suitability of targeted market segments. For instance, products and services should demonstrate a better value proposition to middle class consumer segments, by simplifying the policy terms, reducing overhead and distribution costs and enhancing options for premium payment and loss reimbursement. Yet, many insurers remain insulated from their customers, beset by weak data capabilities and minimal market information, other than that supplied by agents. Companies need to invest in more sophisticated information systems and processes to achieve a better understanding of the customer base, leveraging this insight to establish more direct relationships and improve customer retention.

Wider use of advanced analytics and technology in a few Latin American countries is contributing to enhanced market segmentation capabilities and improved pricing granularity. Leading auto insurers in Brazil, for instance, are using predictive modeling to price risk by the insured peril. Conversely, virtually no Latin American market utilizes consumer profile information to advance ratemaking and customer persistency modeling. This practice is of increasing interest to leading insurers, due to the cross-selling and upselling strategies based on the digital analysis it presents. Increasing competition will pressure insurers to develop data capabilities that track market potential, penetration and performance, as well as customer satisfaction and loyalty.

Develop efficient distribution alternatives

Insurance distribution in Latin America has conformed to traditional systems such as brokers and bancassurance, as cash collection is critical to success. Insurers with owned or partnered distribution channels have thus enjoyed an advantage. Nevertheless, these traditional sales channels generally are not growing in line with expanding populations or addressing more demanding consumer expectations.

Latin American consumers seek demonstrated value when buying insurance, which competes with other purchases such as a new television or a vacation. Insurance sales and service offerings also must address consumer expectations. Across the region, consumers widely use the internet and mobile technology to shop and transact business, which is generally shaping price, information and transaction expectations. Traditional insurance distribution in Latin America has not evolved to keep pace with this changing marketplace. Dramatic changes in insurance distribution appear inevitable and may be the primary basis of differentiation in the evolving insurance marketplace.
Many insurers, for example, are exploiting multiple distribution channels, leveraging social networks and mobile technology to distribute products and provide education and services to customers when and where it is most efficient for them to engage in these interactions. Multi-distribution channels present the potential to improve competitive advantage and market reach, as well as increase insurance sales to middle class consumers.

A one-size-fits-all distribution strategy, on the other hand, has not been effective in Latin America. Current market share by distribution channel varies by insurance product and by country. Eighty percent of life insurance premiums, for instance, are secured through the bancassurance channel in Brazil, while Mexican life insurance distribution is 40% bancassurance, 33% traditional agent and 26% payroll deduction. Personal lines general insurance is distributed predominantly through traditional intermediaries, which can constrain penetration of new and expanding markets.

Latin America consumers are highly engaged users of social networks and mobile technologies. They are very comfortable interacting online and are open to transacting business with online service and product providers. These factors have yet to fully influence the insurance distribution environment, but rapid evolution appears inevitable. Leading distribution innovators are likely to achieve significant market share gains, as they revise their sales and services strategies.

Aside from lower premiums, consumers want insurance products and services delivered as easily and efficiently as other types of online transactions. This remains a key challenge for insurers, requiring that they exploit advanced digital capabilities to drive efficiencies in bancassurance and insurance brokerage, while expanding both online and direct channels.

To generate profitable growth, successful insurers will manage distribution strategies across markets via coordinated channel alternatives. Expanding shop-assurance channels, for instance, provide consumer insurance products to consumers at local markets, e.g., insurance associated with durable good purchases. Mobile applications and social networking, which are growing regionally and by product sector, offer similar opportunities. Changing lifestyles and buying preferences will drive new distribution channel development. Finally, by applying innovative approaches to distribution, insurers increase their opportunities to communicate with customers, thereby extending insurer-consumer touch points that increase the possibility of additional sales.

Critical challenges hindering the development of the Latin American insurance market include a pronounced lack of insurance product awareness and questions over the perceived value among potential customers. To successfully address these issues, insurers must provide targeted financial education, develop online communities for knowledge transfer purposes and support the use of advanced analytics to identify prospects for more personalized communications.
Enhance and embed risk and capital management frameworks

Insurance regulation in Latin America is evolving toward more sophisticated risk-based capital approaches to solvency assessment. This is in line with European and US regulatory trends and more open markets in the Pacific Alliance countries of Chile, Mexico, Peru and Colombia. Having set a 2015 compliance date for a Solvency II-style capital requirement framework, Mexico’s legislation is the most advanced and is likely to be implemented ahead of the rest of the region.

Chile is implementing similar rules required to manage each risk category individually. Solvency regulations are under review in Brazil and Colombia, but both markets are likely headed toward more complex risk-based capital assessments. While the rate of regulatory change differs by country, the direction is clear.

The challenge is that most insurers in the region generally are not technically prepared for this level of risk and capital management. Those that develop sophisticated data analytics and other systems and processes to enhance risk measurement and management along the lines of global standards will secure an advantage over competitors in compliance and capital efficiency. While a significant challenge, successful insurers will develop and leverage more precise measurement of risk into increased capital efficiency and profitability.

Many Latin American countries, such as Argentina, Colombia, Chile, Mexico and Peru, have recently implemented significant tax reforms. These changes include an increase in corporate income tax rates, a withholding tax on dividend distribution and a capital gains tax on the transfer of stock. As these complex revisions and reforms evolve, they suggest substantial consequences, involving deductions for expenses paid to subsidiaries, dividends paid to foreign investors and the calculation of goodwill in a merger. This complexity increases as governments redefine margins and revise tax structures that are outside of international financial reporting standards.

New anti-avoidance rules limiting transactions that may be considered abusive have also been widely adopted. Significant audit activity is now focused on transfer pricing, and in certain cases, taxpayers are required to demonstrate that a given transaction has not been carried out solely for tax purposes. If this is deemed the case, tax authorities can re-characterize the transaction.
The operational complexity foisted on the industry by the regulatory and tax changes insists on more sophisticated structures for management, information and capital systems. Multinationals that have experience with sophisticated solvency regulation have a slight advantage over insurers that lack this experience. Local carriers with complex conglomerate structures comprising businesses besides insurance may find it difficult to expeditiously adapt to the changes. Multinationals also may have greater access to capital to satisfy the emerging capital requirements. All insurers in the region, however, suffer from inadequate access to reliable data. Developing broad, high-quality data on customers and risks would be a prudent first step for the industry to take. For many insurers, such progress is hindered by legacy systems, making access to customer information difficult. Limited analytic capabilities and access to intellectual capital further hinder risk analysis.

**Develop and support insurance talent**

In addition to the high demand for analytic skills, carriers in Latin America also are in the market for underwriting talent. Both skill sets are in short supply. A key factor in the hunt for underwriting talent is the opening of the reinsurance market less than a decade ago, which fostered profound changes in how insurers underwrite business. As the demand for underwriting talent grows and brokers and insurers compete intensely for these skills, costs are rising.

Insurance competition overall continues to narrow average profit margins in the industry. To drive higher top line and bottom line results, superior underwriting capabilities have become a critical differentiator among insurers. Ensuring underwriting talent on top of evolving technical skill needs is another challenge. For example, new process structures require the management of multiple product offerings and distribution channels.

Increasing these demands on underwriters is the need to develop high quality, high value insurance products at competitive prices. In turn, this compels insurers to recruit underwriters of significant intellectual capital from universities and other industries, and effectively train these individuals. One source of this external talent may derive from the strong use of the bancassurance model in the region.
For the most part, insurers in Latin America have lacked a widespread appreciation for recruiting top intellectual capital, and only a few universities have risk management degree programs. Successful companies will need to solve these problems through enhanced internal training and development, an increased focus on talent retention and successful recruitment from outside the industry and the region.

**Advance data quality and precision**

As competition in Latin American markets intensifies and solvency regulation moves toward European structures, expect increasing sophistication among insurance competitors. Preparing for digital enhanced competition and risk management requires that insurers overcome legacy insurance technology to “rewire” their processes and enterprise business intelligence. Technology investments must focus on enhanced underwriting capabilities and innovations in distribution that involve a customer-facing experience.

Insurers in the region are beginning to leverage data analytics and related algorithms to determine pricing models. Consequently, data availability and quality are critical challenges to market development and profitability; i.e., limited customer profile information hampers such advanced ratemaking and customer persistency modeling. Increasing the breadth and granularity of customer data for analytical purposes will enhance insurer-customer interactions for both life and general insurance. Sources for data mining include social media, mobile communications and telematics connected to automobile usage. Recognizing that intermediaries are also digital customers, insurers should support their agents’ digital strategies to reduce channel conflict.

Solvency regulation also compels the industry to consider wide use of advanced risk and capital management systems. These demands require technical analyses of risk based on customer behaviors, as well as more precise measurements of exposures.

Effective analytic capabilities in market segmentation and predictive modeling are critical to gaining digital success in 2014. Successful insurance companies will be highly digital, intensely focused on the customer and pursuing an enterprise-wide analytics approach that takes into account strategic, operational and cultural factors. Vigilant data stewardship also is required to assure internal and external data quality. Insurers also must incorporate technical talent needs with local market knowledge to assure quality analysis in a regional context.

Insurers are at different stages of development in their digital evolution. Challenges are significant, given the high demand for specialized technology talent and the dynamic underlying conditions. EY’s Global Digital Survey of industry players affirms that analytics capabilities is the skill set most in demand among insurers.
## Latin American critical risks and opportunities

<table>
<thead>
<tr>
<th>Regional focus</th>
<th>Risks</th>
<th>Opportunities</th>
<th>Emerging challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America generally</td>
<td>Disparate regulatory</td>
<td>Expanding middle class</td>
<td>Consumer education</td>
</tr>
<tr>
<td></td>
<td>Inflation</td>
<td>Maturing industries</td>
<td>Distribution costs</td>
</tr>
<tr>
<td></td>
<td>Catastrophe</td>
<td>Opening markets</td>
<td>Data quality</td>
</tr>
<tr>
<td></td>
<td>Consumer regulation</td>
<td>Risk modeling</td>
<td>Customer segmentation</td>
</tr>
<tr>
<td>Brazil</td>
<td>Increased regulation</td>
<td>Modernizing infrastructure</td>
<td>Product differentiation</td>
</tr>
<tr>
<td></td>
<td>Naive competition</td>
<td>Emerging small businesses</td>
<td>Market acceptance</td>
</tr>
<tr>
<td>Colombia, Mexico</td>
<td>Transitioning regulatory</td>
<td>Business sector reforms</td>
<td>Expanded premium drivers</td>
</tr>
<tr>
<td>Chile</td>
<td>Income disparity</td>
<td>Ease of doing business</td>
<td>Product expansion</td>
</tr>
<tr>
<td>Argentina, Venezuela</td>
<td>Local protectionism</td>
<td>Rapid growth</td>
<td>Flexible market participation</td>
</tr>
<tr>
<td></td>
<td>Political encroachment</td>
<td></td>
<td>High inflation</td>
</tr>
<tr>
<td>Peru, Ecuador</td>
<td>Volatility</td>
<td>Rapid growth</td>
<td>Small market size</td>
</tr>
</tbody>
</table>
### Year over year change in total insurance premiums for selected Latin American countries
(Adjusted to US exchange rates as of 31 December each year*)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>42%</td>
<td>-13%</td>
<td>49%</td>
<td>25%</td>
<td>5%</td>
<td>11%</td>
<td>4%</td>
<td>18%</td>
</tr>
<tr>
<td>Chile</td>
<td>23%</td>
<td>19%</td>
<td>-10%</td>
<td>33%</td>
<td>17%</td>
<td>17%</td>
<td>0%</td>
<td>14%</td>
</tr>
<tr>
<td>Colombia</td>
<td>22%</td>
<td>13%</td>
<td>16%</td>
<td>12%</td>
<td>17%</td>
<td>22%</td>
<td>2%</td>
<td>15%</td>
</tr>
<tr>
<td>Mexico</td>
<td>16%</td>
<td>-15%</td>
<td>21%</td>
<td>5%</td>
<td>2%</td>
<td>21%</td>
<td>18%</td>
<td>10%</td>
</tr>
</tbody>
</table>

*Brazil: Superintendencia de Seguros Privados (SUSEP)
*Chile: Asociacion de Aseguradores de Chile A.G. (AACH)
*Colombia: Superintendencia Financiera de Colombia
*Mexico: Comision Nacional de Seguros y Fianzas (CNSF)

### Corporate income tax rates for insurance companies and general domestic withholding tax rates on dividend distributions
(Selected Latin American countries)

<table>
<thead>
<tr>
<th></th>
<th>Corporate income tax rate</th>
<th>Divided withholding tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>35%</td>
<td>10%</td>
</tr>
<tr>
<td>Brazil</td>
<td>40%</td>
<td>0%</td>
</tr>
<tr>
<td>Chile</td>
<td>20%</td>
<td>35% (minus CIT credits)</td>
</tr>
<tr>
<td>Colombia</td>
<td>25% + 9% CREE tax</td>
<td>0%</td>
</tr>
<tr>
<td>Mexico</td>
<td>30%</td>
<td>10%</td>
</tr>
<tr>
<td>Peru</td>
<td>30%</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

### Most costly windstorms in Latin America (not also hitting the US)

<table>
<thead>
<tr>
<th>Name</th>
<th>Damage US$ billions</th>
<th>Year</th>
<th>Storm classification at peak intensity</th>
<th>Areas affected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Karl</td>
<td>$5.60</td>
<td>2010</td>
<td>Category 3 hurricane</td>
<td>Belize, Mexico</td>
</tr>
<tr>
<td>Gilbert</td>
<td>$5.00</td>
<td>1988</td>
<td>Category 5 hurricane</td>
<td>Venezuela, Central America, Hispaniola, Mexico</td>
</tr>
<tr>
<td>Stan</td>
<td>$3.96</td>
<td>2005</td>
<td>Category 1 hurricane</td>
<td>Mexico, Central America</td>
</tr>
<tr>
<td>Matthew</td>
<td>$2.60</td>
<td>2010</td>
<td>Tropical storm</td>
<td>Venezuela, Jamaica, Central America</td>
</tr>
<tr>
<td>Luis</td>
<td>$2.50</td>
<td>1995</td>
<td>Category 4 hurricane</td>
<td>Leeward Islands, Puerto Rico, Bermuda</td>
</tr>
<tr>
<td>Michelle</td>
<td>$2.15</td>
<td>2001</td>
<td>Category 4 hurricane</td>
<td>Central America, Jamaica, Cuba, The Bahamas</td>
</tr>
<tr>
<td>Joan</td>
<td>$2.00</td>
<td>1988</td>
<td>Category 4 hurricane</td>
<td>Lesser Antilles, Colombia, Venezuela, Central America</td>
</tr>
<tr>
<td>Fifi</td>
<td>$1.80</td>
<td>1974</td>
<td>Category 2 hurricane</td>
<td>Jamaica, Central America, Mexico</td>
</tr>
<tr>
<td>Dean</td>
<td>$1.78</td>
<td>2007</td>
<td>Category 5 hurricane</td>
<td>The Caribbean, Central America</td>
</tr>
<tr>
<td>Marilyn</td>
<td>$1.50</td>
<td>1995</td>
<td>Category 3 hurricane</td>
<td>The Caribbean, Bermuda</td>
</tr>
</tbody>
</table>

**Sources:**
- “Según cálculos de Kuri Grajales, Karl causó daños al estado por 12 mil mdp,” La Jornada Veracruz, Fernando Ines Carmona, 19 September 2010.
- Fondo Nacional de Desastres Naturales: a fund for disaster relief in Mexico with contributions to Hurricane Karl relief.
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US life-annuity

Significant opportunities and challenges in a highly competitive environment
Market summary

Evolving external forces and improved internal operating fundamentals confront the US life insurance-annuity market at the onset of 2014. Given the rise in consumer confidence and continuing improvements in the economy and marketplace, life insurers are poised to become more aggressive and less defensive, renewing initiatives to expand into underpenetrated parts of the market.

In 2014, rising interest rates, the ongoing economic recovery, and the improving employment and housing markets should boost consumer confidence and personal wealth, creating greater sales opportunities for life insurers. As the financial protection and savings needs of middle-market customers increase, retirement and pre-retirement market solutions put on hold during the financial downturn are urgently needed. Challenges include a more empowered insurance consumer, due to advances in communications, data analytics and other information technologies, and the uncertain impact of regulatory and accounting changes and proposals. The latter will require companies to re-evaluate and adjust their business based on an analysis of their competitive position, financial strength and future capital requirements.
The improved internal operating fundamentals of the life insurance-annuity industry are giving companies the confidence to take advantage of these changing external forces. The industry has successfully rebuilt its capital position and is now poised to deploy this capital into profitable business opportunities. Nevertheless, the increased focus on risk and risk-adjusted returns on capital by regulators compels companies to efficiently use and structure capital to maximize the opportunity. Such discipline is required for life-annuity insurers to achieve growth objectives. Successful companies are rebuilding product portfolios, de-risking unsustainable guarantees and providing new, more cost-effective offerings to traditional and expanded markets.

With respect to the high-net-worth and mass-affluent market segments, insurers are positioned well, with a portfolio of re-priced variable annuities, an expanding line of indexed and deferred income annuities, and life insurance products targeting estate planning. Insurers eyeing growth opportunities beyond these segments are developing cost-effective ways to distribute to mass-market consumers, who are increasingly open to purchasing life insurance and annuities through alternative distribution channels. To attract such consumers, insurers must segment their mass-market approaches, responding to the demographic, socioeconomic and digital diversity of the customer base.

Insurers that seek growth opportunities in 2014 can maximize profits by maintaining a diligent focus on bottom line results and risk management. By overcoming the growth impediments presented by legacy systems and service issues and leveraging sophisticated technology and data analysis techniques, insurers can streamline operations, improve their value proposition and support robust growth strategies. Such investments in people, processes, methodologies and technology will enable insurers to address upcoming regulatory and accounting requirements for risk analysis, distribution oversight and information transparency. Although the implementation date for these initiatives remains uncertain, they nonetheless must remain in focus. Companies need to build management and information capabilities to minimize regulatory impact and maximize the opportunity to differentiate their value proposition to stakeholders.
To successfully move from playing defense to taking the offense, insurers must:

- Become more customer centric and adopt digital technologies to reach expanding markets
- Streamline operations to improve efficiency and resolve legacy systems
- Invest in enterprise data excellence
- Improve capital efficiency
- Anticipate and prepare for regulatory and accounting changes

**Become more customer centric and adopt digital technologies to reach expanding markets**

In the highly competitive market conditions, insurers must deepen their relationships with customers, which is vital to retaining this book of business and maintaining sustained, profitable growth. The good news is that the insurance market is expanding; recent improvements in the economy have given consumers greater resources to consider the purchase of insurance products. To capture this growth opportunity, successful companies are transforming from a product-focused model to a customer-centric one. This transformation requires expanded use of digital technologies to optimize the customer experience.

Recent technological advances in social connectivity and data analytics have empowered the global consumer. Consumers routinely leverage social media and peer-to-peer product reviews in their buying decisions. Global insurance executives maintain that a key strategic challenge is the ability to effectively respond to customers’ rapidly evolving requirements for product transparency, quality service and communications, and enhanced recognition of customer loyalty.

Most US life insurers acknowledge low levels of digital sophistication, according to EY’s survey *Insurance in a digital world: the time is now*. Fifty-seven percent of respondents stated their intentions to develop a regularly updated digital business case, and 78% said they expect to have an organizational structure to support digital strategies in place within the next three years. These high expectations for change are challenged by legacy technology and cultural constraints. Although 40% of respondents indicated they had senior management support and a digital sponsor within the C-suite, 68% of life-annuity respondents acknowledged spending less than 10% of their business and IT development budgets on digital initiatives.
Digital technology also challenges traditional distribution channels — the ways customers engage with insurers. Nevertheless, EY insurance consumer surveys show that personal interaction is still highly regarded. The complex nature of insurance products, combined with customers' need for advice, indicates that personal interaction will remain important to an overall channel strategy. Following regulations in 2013 that clarified the use of social media, insurers are integrating social media with other distribution and communication channels to strengthen customer experience.

To be successful in the digital age, insurers need to enhance their distributors' financial planning knowledge and advisory skills. Insurers must leverage digital and mobile technologies to effectively reach customers who prefer a direct contact with the insurer. Since distributors also provide customer support, insurers need to open and integrate their administrative systems with distributors' back offices. This integration would streamline application processing and improve customer service. To meet the needs of consumers and distributors, insurers in 2014 must invest further in automating application processing and integrating insurer/distributor back offices.

Now that mobile devices are a primary way for many people to access the internet, insurers must adapt their digital capabilities to this phenomenon, despite current budget pressures. The goal is to understand how to make digital technology a more effective part of the overall customer experience.
Streamline operations to improve efficiency and resolve legacy systems

Stagnant sales and low investment yields are combining to constrain profits, compelling a re-evaluation of existing operational models and cost structures. Implementing shared services across the organization can streamline processes, guide long-term operational excellence and increase long-term profitability. A shared operations centers that supports underwriting, policy administration, claims management and other core business functions across the product portfolio is an attractive model for life insurance.

Centralization and shared services can improve efficiency across the enterprise, helping a company maintain profits in the low-interest-rate environment. Basic policy functions, such as billing, the processing of premium payments and the issuing of statements, are similar for a broad range of policies. The problem is that many insurance companies have legacy systems and duplicative functions – different teams handling the same basic work and activities at varying levels of competency and performance. Ongoing maintenance of legacy systems and overlapping functions divert resources that would be better invested in integrating functions across the company.

The value of shared services is exclusive to expense savings. Two opportunities include the ability to increase the speed to market for new products and to improve regulatory compliance. New regulations demand a more rigorous, automated and repeatable approach to managing risk. Capturing the required data and complying with complex reporting requirements are steep challenges, constrained further by inefficient systems, manual processes, and costly and error-prone reports. Shared services centers can streamline the process of regulatory reporting while mitigating the risk of non-compliance. A shared back office also assists greater speed to market by adapting the successful features of one product to other products.

Outsourcing and co-sourcing remain viable ways to improve efficiency. A 2013 survey by EY indicates that 82% of respondents were outsourcing or co-sourcing some internal audit capabilities. Outsourcing to third-party service providers brings a fresh perspective, given their extensive experience working with other clients, while co-sourcing blends the flexibility of temporarily adding third-party personnel with the continuity provided by internal staff. Via a mix of shared services, outsourcing and co-sourcing, companies can reduce their overall expenses and compete more effectively in the expanding market.
In 2013, many insurers began the transformation of data and information systems. Aware that legacy data may contain errors, be unclear and otherwise unreliable, and be of little if any strategic use, these companies invested in the concept of enterprise data excellence, a process often under the governance of a chief data officer that encompassed five levels of data management and implementation:

1. Enterprise intelligence establishes common standards and policies under a common architecture. Integrated systems are aligned with business priorities, linking source data through operations to final reporting needs to simplify, optimize and improve the existing infrastructure and meet the demands of ever-changing requirements. Companies rethink how data is captured, stored and used by the business and executive leadership, turning data into a strategic business asset.

2. Enhanced analytics includes technology applications that monitor systems and provide analytics support with minimal intervention or frictional cost. Companies define data enrichment strategies involving internal and external data. Analytics turns this data into information for decision-making purposes, such as a faster response to emerging claims issues.

3. Predictive analytics to optimize risk and capital analysis. Such tools should be integrated across the value chain, from distribution, underwriting and business processes to claims and investment applications.

4. Data governance to define and optimize data ownership and controls under a chief data officer. This role has transformed from an internal servicing function to a strategic resource providing actionable reporting. A data governance framework must be clear about data ownership, standards and policies. Effective processes and procedures need to be established for the capture, movement, usage, storage and disposal of information.
5. Data security to protect against an exponential rise in cyber attacks, both from within and outside the country. Cyber crimes in which hackers steal names, social security numbers and other identifying information threaten many US insurance companies. Regulations governing data in transit and in storage, as well as rules addressing information sharing, data privacy and adoption of cybersecurity practices, have been implemented or are in the process of implementation.

While many companies have established some level of competence in these areas, the approach is fragmented and incomplete. Companies that improve data management at all five levels of enterprise data excellence will outperform competitors in 2014 and beyond.

**Improve capital efficiency**

In the post-financial crisis years, insurers rebuilt their capital to weather the difficult financial times. The industry, regulators and investors have a new appreciation for the tail risks of investments, products and policyholder behaviors, especially how these risks can be unexpectedly correlated. Since excess capital lowers investor returns, companies are moving to improve their capital efficiency. At the same time, they are looking to balance their regulatory requirements for capital adequacy with the capital markets' requirement for an adequate risk-adjusted return.

Insurers can enhance shareholder returns by improving the yield on investments in products and operations. Similarly assisting this objective are reductions in capital requirements through product portfolio management and the restructuring of capital through the use of captives or debt. To achieve the optimal balance of risk and reward, insurers must carefully evaluate their investment strategy, product portfolio and capital structure.
The investment environment for life-annuity insurers in 2014 will be challenging. In 2013, core investment income performance continued its downward slide and is likely to fall another 15 basis points before year-end. The 100 basis points upswing in longer-term bond yields from May to November 2013 holds promise that investment income trends may become more favorable. Nevertheless, embedded portfolio yields will continue to fall as maturing investments roll over at the still-low rates. Furthermore, the potential of a sharp upswing in rates could create an environment where customers consider lapsing existing products in favor of more appealing products, either within or outside the life insurance industry.

In a volatile economic environment, life insurers confront heightened liquidity and capital demands. During the recession, companies modified their products by re-pricing them or removing guarantees. New products also were created with more cost-effective offerings. Insurers in 2014 must take the next step and develop economic capital models that support products, optimize capital and enhance risk management. Capital models must identify broad risks, particularly interest rate movements that affect product maturity, quality and liquidity.

Insurers also must assess policyholder behavior and how it affects their product portfolio. They must evaluate these risks by product (how benefits and options are exercised) and across multiple products (policies that lapse in ways not anticipated when pricing the product). Insurers can respond by re-pricing behavior-sensitive products or reallocating risk capital. Some companies may decide to discontinue products or product features because of the risk and capital implications. In all cases, risk-adjusted return on capital and similar metrics are key in re-evaluating product mix and investment allocation.

The aging of the baby boomer generation presents significant capital implications for providers of life insurance and annuities. Insurers enjoyed a long period of sales when baby boomers were saving for retirement. Now, more than 3 million baby boomers will reach age 65 in 2014 alone, curtailing further investment and beginning to draw upon built-up savings. The industry now confronts the need to make payouts to boomers, at a time of slow growth and low investment yields.
Successful insurers in 2014 will be balancing risk and reward in their asset portfolios, seeking yield while ensuring they are rewarded for the retained risk. Asset/liability mismatch and liquidity risks will be under the microscope, evaluated by new risk metrics that determine the impact of disparate scenarios, such as a rise in interest rates, on company capital.

One method of optimizing capital is the formation of captives. Captive reinsurance can reduce surplus strain, increasing the return for in-force business while increasing the capacity for new business. Increased regulatory scrutiny of these arrangements requires a careful balancing act with other risk capital approaches, such as diversifying product mix or using third-party reinsurance. Properly managing capital within a highly challenging macro-environment will require collaboration across functions.

An important factor in all these efforts is transparency. To gain the confidence of everyone inside the organization and from external stakeholders, capital efficiency and modeling efforts need to be clearly communicated. A lack of risk transparency can create wariness among regulators and other external stakeholders. If investors are skeptical of the risks on an insurer’s balance sheet, its price-to-book ratio may be relatively low. To reap the full benefits of capital efficiency strategies, insurers need to provide stakeholders transparency and clarity in risk-related communications.
Anticipate and prepare for regulatory and accounting changes

Many new and proposed regulations were promulgated in response to the financial crisis. The trend toward greater regulatory intervention and related pressures on insurers will continue in 2014.

Insurers have long faced a complex regulatory environment. Changes in recent years increase the need to assess enterprise risks, heighten operational transparency, enhance governance efficiency, and establish clear risk ownership and accountability. Although the implementation timeframe of several regulations remains uncertain, successful insurers in 2014 will be improving their governance structures.

US life insurers will soon confront the National Association of Insurance Commissioners’ (NAIC) Own Risk and Solvency Assessment (ORSA) rule, as well as fundamental changes to US and international accounting changes and additional federal and international oversight. While regulators have set timelines for implementation in 2014 and 2015, there is no guarantee these dates will be met, and it is unclear what the final rules will look like once implemented. This uncertainty creates hesitancy for insurers regarding how to adapt data, technology and processes to comply with the regulations.

The first NAIC ORSA reports are due in January 2015, and final testing and rollout is expected during 2014. Although the official NAIC ORSA manual is fairly short, little guidance is provided regarding what will be expected of insurers (in contrast to the detailed ORSA requirements in the EU’s Solvency II initiative). The lack of clarity behooves insurers to undertake communications with regulators as they continue to develop the rules. It is similarly prudent to ensure compliance with the core principles, at a minimum. For some insurers, disparate risk reporting and governance systems may need to be integrated or replaced by more comprehensive systems to achieve enterprise-level measurements of risk.

Both the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued revised accounting standards exposure drafts on insurance contracts in 2013. The revisions contain new approaches to balance sheet and income statement presentation for insurance and insurance-like guarantees. Insurers need to analyze the impact of these accounting changes, making a choice between International Financial Reporting Standards and US generally accepted accounting principles. Added to ORSA and IASB/FASB requirements, insurers must focus on improving their modeling capabilities, data quality, data governance, and the level of detail provided in their reporting and modeling systems.
Actions from federal regulatory bodies also confront the industry in 2014. The Financial Stability Oversight Council designated two US life insurers in 2013 as systemically important financial institutions (SIFIs) (a third insurer was in the final stages of the designation process). SIFIs will be subject to oversight by the Federal Reserve, in addition to state regulators, and must submit a recovery and resolution plan to the Federal Reserve. The requirements are expected to be phased in during the second half of 2014.

At the same time, six international insurers were designated global systemically important insurers (G-SIIs) by the Financial Stability Board. Such designations place increasing demands on insurer resources and capital requirements. They may also create a competitive advantage for certain insurers, implying the security of an implicit government backstop.

For multinational insurers, the complexity of cross-border supervision and regulation may be the next big challenge. Companies will need to develop new skills and frameworks as they arrive at common understanding of regulatory and industry expectations. The broader designation of SIFIs or G-SIIs may reach into questions of a common standard for capital measurement and a common framework for capital regulation.

Insurers will need to consider not only the direct impact of a SIFI/G-SII designation, but also the impact to their reinsurance or other interinsurance company arrangements. Aside from the uncertainty surrounding the impact, there is some dissension among regulators, evidenced in the various competing bodies with overlapping mandates clashing over control. Consequently, insurers may face multiple conflicting requirements. To thrive in this rapidly changing regulatory environment, they require the capacity and expertise to understand, analyze and communicate changes to both internal decision-makers and external stakeholders.
US property-casualty
Focus on margin protection and stronger operating fundamentals to enhance performance
Market summary

Changing external forces and stronger international operating fundamentals will characterize the 2014 property-casualty insurance market environment in the United States. These evolving forces include the economic environment, interest rate conditions, the industry’s capital position and its effect on competition, and the pace of technological change. Other pressures include the increasing empowerment and marketplace expectations of the consumer, the stricter regulatory environment and the increasing frequency and volatility of catastrophes. These forces are expected to have an even greater impact in 2014 on the performance opportunities for US property-casualty insurance companies and on their strategic decisions.

In contrast, these forces have not had as great an impact in 2013. The economy and interest rate trends appear stable, if not improving; catastrophe experience has been moderate, at a time when pricing for reinsurance protection is improving; and capital levels continue to increase on pace with premiums. Nevertheless, these issues remain volatile and their impact should not be underestimated in 2014.

External forces in 2014

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Stronger internal operating fundamentals

Stronger internal operating fundamentals are supporting a sustainable recovery in the US property-casualty industry. Evidence of this improvement is reflected in the stock valuations for publicly traded US property-casualty companies, which have rebounded after several years of subpar performance. Since 2010, best-performing insurers have steadily improved their core financial performance.

The magnitude of these improvements had been obscured by the financial impact of periodic catastrophes and net loss reserve releases in recent years. Other factors were the slow recovery in the industry’s exposure growth and its investment performance in the still weak economy. While recent GDP growth remains well below historical trends, growth is expected to continue in 2014. Investment yields increased in mid-2013, albeit slightly, and overall investment income levels may improve further in late 2014 or early 2015.
To a large degree, the improvement in the industry’s core financial performance is driven by the re-emergence of pricing and underwriting discipline, surpassing loss cost growth and widening operating margins. This is particularly evident in workers’ compensation, where strong pricing and moderating loss performance are combining to turn operating results in the direction of underwriting profitability. Best-performing companies are taking steps beyond pricing and underwriting discipline, leveraging data and enhanced analytics to refine their market segmentation strategies across all lines. Such insurers have seized regional and sector growth opportunities domestically and globally. They are also leveraging technology to improve distribution and operating efficiencies and to achieve greater access to consumers and the commercial marketplace.

Many successful insurers are in various stages of implementing a customer-centric business model, as opposed to a product-centric model. This new model compels a fundamental realignment and integration of internal technology to reach consumers and commercial customers. In this regard, high-performing companies are recruiting executive talent who have experience with advanced technologies. These insurers see closer alignment of technology with commercial objectives as a strategic imperative.

The improvement in external market conditions may provide the opportunity for insurers to widen their performance advantage, despite ongoing marketplace fragility and the need for continuing vigilance in facing economic, competitive and regulatory challenges. Strong capital ratios relative to premium and loss growth, which typically stimulate competition, may relax current pricing discipline, as may the growing importance of distribution aggregators, comparative raters and direct marketing to consumers. These developments tend to emphasize price comparisons rather than service and product distinctions.

Similarly, slower loss growth, a consequence of the sluggish economy, may increase loss cost inflation and cause adverse claims experience. Changes implemented in the health care arena, for example, may shift the control of pricing to government and large health care providers, resulting in medical cost inflation for the rest of the marketplace. The variability of regional weather-related losses and emerging coverage challenges likewise make it difficult to effectively manage and mitigate these exposures. The possibility of volatile investment performance and inflation further pressures effective balance sheet management. Lastly, heightened governance reporting at state, federal and international levels may stress the capacity of company management teams to provide the high volume of requested information.

To solidify recent gains and defend against new risks and challenges, US property-casualty companies must augment their focus on margin protection and operating effectiveness in 2014. Successful companies must:

• Double down on broad-based, transformative technology with high ROI impact
• Adopt a complete range of enterprise data excellence

While recent GDP growth remains well below historical trends, expectations for 2014 indicate continuing economic growth.
• Invest in innovation of product development processes and delivery to meet rising demand for protection

• Exploit segment differences for targeted growth strategies

• Get out in front of emerging investment challenges

• Prepare for escalation of governance and accountability

1. Double down on broad-based, transformative technology with high ROI impact

In a continuing low interest rate environment, insurers need to increase internal investment in technology and operating capabilities. A rare opportunity exists to broadly transform technology, replacing core engines with fully integrated, cost-effective cloud-based systems for distribution, underwriting, product development and claims. Making such investments, companies can drive down frictional operating costs, increase access to data and information across organizational silos, and enhance speed to market to improve profitability in the increasingly price-competitive environment.

An important catalyst for these investments is the imperative to replace the traditional product-centric model with a customer-centric model. Straight-through processing can strengthen the value proposition with agents, and mobile technology can reach and service markets that increasingly demand convenience and a flexible interface. The latter can be leveraged across all steps in the value chain, such as direct channels and agent-powered distribution, as well as claims.

A recent EY survey of global insurance executives, Insurance in a digital world: the time is now, highlights both progress and continuing challenges. Insurers acknowledge a low level of digital sophistication and a dire need to take action, with 57% of respondents expressing their intentions to develop a business case for transforming their organizational structure to support digital strategies, and 78% anticipating this development within the next three years. While the respondents have high expectations for change, they noted both legacy technology and cultural constraints, with 79% acknowledging spending less than 10% of their business and IT development budgets on digital initiatives. Nevertheless, 40% indicated they have senior management support to transform their technology, as well as a digital sponsor within the C-suite.

Assisting the argument for transformation is the need to enrich the customer experience, the growing importance of intermediaries and agents as digital customers, and the communications and customer experiences brought about by mobile devices and social media, which have fundamentally changed consumer expectations. Coupling processes and technology with advanced analytics will guide meaningful improvements.

Strong capital ratios relative to premium and loss growth, which typically stimulate competition, may relax current pricing discipline.
2. **Adopt a complete range of enterprise data excellence**

In 2013, many insurers began the transformation of data and information systems. Aware that legacy data may contain errors or be otherwise unreliable and of little strategic use, these companies invested in “enterprise data excellence,” a process often under the governance of a chief data officer that encompasses five levels of data management and implementation:

1. **Enterprise intelligence** establishes common standards and policies under a common architecture. Integrated systems are aligned with business priorities, linking source data through operations to final reporting needs to simplify, optimize and improve the existing infrastructure and meet the demands of ever-changing requirements. Companies rethink how data is captured, stored and used by the business and executive leadership, turning data into a strategic business asset.

2. **Enhanced analytics** includes technology applications that monitor systems and provide analytics support with minimal intervention or frictional cost. Companies define data enrichment strategies involving both internal and external data. Analytics turns this data into information for decision-making purposes, such as a faster response to emerging claims issues.

3. **Predictive analytics** to optimize risk and capital analysis. Such tools should be integrated across the value chain, from distribution, underwriting and business processes to claims and investment applications.

4. **Data governance** to define and optimize data ownership and controls under a chief data officer. This role has transformed from an internal servicing function to a strategic resource providing actionable reporting. A robust data governance framework supports clear data ownership, standards and policies. Effective processes and procedures are established for the capture, movement, usage, storage and disposal of information.

5. **Data security** to protect against an exponential rise in cyber attacks, both from within and outside the country. In 2013, many US insurance companies were hit by cyber attacks, whereby hackers stole names, Social Security numbers and other identifying information. In 2013, computer security experts discovered the existence of a highly sophisticated group of hackers for hire, operating in conjunction with foreign operations. Government action in the wake of these events was inevitable. In February 2013, President Barack Obama signed an executive order addressing information sharing, privacy, and adoption of cybersecurity practices. Subsequently, the Obama Administration reached out to the insurance industry about its cybersecurity.

While many companies have established some level of competence in these areas, the approach is fragmented and incomplete. Companies that improve data management at all five levels of enterprise data excellence will outperform competitors in 2014 and beyond.
3. Invest in innovation of product development processes and delivery to meet rising demand for protection

Highly disruptive technologies are changing products, services and customer interactions across the economy. Consequently, new risks and insurance needs are emerging for consumers and the commercial marketplace. In many cases, these risks have a legislative or legal foundation for defining risk and coverage needs, thereby increasing awareness and focusing demand. To improve their ability to design and develop new products quickly and efficiently, as well as improve speed to market, many companies are leveraging technology and enhanced customer-centric processes.

Risks requiring broader, cost-effective insurance industry solutions include:

- **Cyber insurance.** The rapid increase in hacking incidents and data privacy liabilities has surpassed the ability of most commercial enterprises to keep pace. Insurers can provide increased coverage and loss mitigation services, applying data analytics and other technologies to assist insureds.

- **Catastrophe insurance.** The increasing uncertainty and volatility of catastrophes has heightened the demand for broader risk protection. The potential emergence of a private flood market augmenting the national flood insurance apparatus is a case in point. The rising flood exposure has also spawned greater demand for contingent business interruption coverage, particularly for supply chain exposures. Insurers also need to prepare for private terrorism coverage exposures, given a potentially limited federal backstop.

- **Workers’ compensation.** The changing health care market, particularly new services in partnership with employers for accelerated rehabilitation and cost-effective traumatic injury medical services, is demanding more effective insurance solutions.

- **Nanotechnology.** The emerging applications of nanotechnology in the manufacture or use of medicine, cosmetics, drug delivery, robotics, materials science and other products and systems create potential liability exposures. Examples include bodily injury (analogous to asbestos exposure) and environmental damage from nanoparticles escaping uncontrolled into the air or water supply. The lack of any meaningful history with this technology, as well as with the materials involved, indicate the potential risks cannot easily be assessed.

- **Sensor technology.** The use of sensors in telematics and in consumer and industrial products can create increasingly integrated exposure information for insurers, while enhancing the ability to provide more cost-effective and targeted risk protection for customers.
Emerging technologies and products have led insurance and reinsurance organizations to establish centers of science to explore new approaches to risk measurement and mitigation. Companies are increasingly seeking executive talent that can drive and lead such new thinking and new approaches.

Customer perceptions of new or changing risks will guide coverage enhancements, possibly opening the market to new entrants that understand these risks. To effectively compete in this environment, companies will need to rationalize their current and often complex portfolios of products, employing technology to simplify the delivery and processing of their product offerings, in addition to improving their response times.

4. Exploit segment differences for targeted growth strategies

In 2014, companies exploiting pockets of opportunity (global, geographic, product and demographic) will achieve the best growth and bottom-line performance. Nevertheless, the economic recovery and the competitive environment remain fragile in the United States. Economic differences exist at both state and regional levels, increasing volatility in cost drivers and affecting the competitive dynamics in market segments:

- Specialty markets (particularly excess and surplus lines markets) are experiencing an upsurge, with premiums shifting from standard markets. Pricing has firmed across the spectrum, and the competitive marketplace is being transformed with new entrants and products. These markets require a specialized understanding of risk. Success requires adequate pricing discipline, as well as sufficient experience and analytical capabilities.

- Workers’ compensation performance is broadly turning the corner toward improved growth and cost containment. Loss frequency for lost-time cases is trending downward, medical costs appear relatively contained and premium growth is accelerating. Trends vary significantly by state and industry type and are affected by different regulatory interventions and economic drivers. For example, California’s premium growth rates are more than double the national average, yet loss frequency appears to be on the rise, in contrast to rest of the country.

- Companies need to exploit regional differences in economic growth and underwriting prospects. Strong economic performance in the middle of the country surpasses the performance on either coast. Economic fundamentals are expected to improve in the West and Southeast in 2014, led by California and Florida. Population and employment drivers, industry-specific economic trends, changing competition, and a volatile regulatory and political environment also produce disparate opportunities and risks.

- Alternative capital structures are reshaping both the primary and reinsurance markets, presenting opportunities and challenges. Insurers and customers are increasingly using captives and alternative risk retention vehicles as long-term capital management solutions, rather than as opportunistic vehicles to escape price distortions. The expanded presence of third-party capital and the development of capital market
alternatives in the reinsurance marketplace (led by the property catastrophe market) are restructuring the supply and demand relationships. The increase in capital has already pushed reinsurance rates lower, and it may put downward pressure on primary pricing for property coverage, as well. Although alternative capital has largely been confined to catastrophic property risks, additional products and applications for third-party capital are possible. These changes challenge fundamental assumptions of pricing and market dynamics, opening up new growth possibilities while constraining otherwise traditional market areas.

- Merger and acquisition activity offers the opportunity to immediately increase market share in existing business segments and gain scale in attractive new markets. The recent recovery in equity values has the potential to increase capital for acquisitions and buyer confidence. Companies seeking to rapidly exploit emerging segment opportunities are eyeing established teams and specialty-oriented vehicles to gain speed to market. That said, M&A presents diverse risks requiring specialized due diligence and analytics.

Exploiting segment opportunities to achieve growth requires advanced analytics and real-time information on competitors and segment dynamics. A granular view of regional and demographic factors, as well as a systematic focus on known and emerging competitor activities, is needed. Capturing, analyzing and integrating internal and external information generated across a company’s operating areas is invaluable in accurately assessing new business opportunities while protecting the existing customer base.

5. Get out in front of emerging investment challenges

The challenging investment environment is expected to persist in 2014. In 2013, core investment income performance deteriorated, with yields at record lows. Across the industry, 85% of investments are in fixed income instruments. The tax-equivalent book yield on all invested assets for the US property-casualty sector fell by 70 basis points (or 14%) from 2008 through 2012. A decline of another 20 basis points in 2013 is anticipated. Nevertheless, the recent 100-basis-point upswing in yields that began in May 2013 may indicate more favorable investment income trends ahead. Still, embedded portfolio yields will continue to fall as maturing investments roll over at the still-low rates, and the potential for higher interest rates invites additional challenges.

Companies have sought refuge by altering traditional investment allocations. Across the industry, positions in common stock, lower-rated bonds and alternative investing vehicles are increasing, while the allocation to traditional higher-rated bonds is declining. The industry seeks to diversify investment exposure and moderately increase yields by incrementally expanding its positions in equities and lower correlated alternative investment classes, such as commodities and hedge funds. Nevertheless, these efforts are constrained by accounting treatment, capital charges and the need to develop more robust risk analyses of different asset classes.

In 2014, companies exploiting pockets of opportunity (global, geographic, product and demographic) will achieve superior opportunities for growth and bottom-line performance.
A greater emphasis on risk and capital management exists in the industry, driven by unanticipated losses on both the asset and liability sides of the balance sheet. To support decisions and respond to increased scrutiny from regulators and rating agencies, many insurers have embraced economic capital modeling and economic scenario modeling in their enterprise risk management frameworks.

To test their resilience to a sudden rise in interest rates, given the prolonged period of low rates, boards of directors, risk committees and chief risk officers should engage further in such structured exercises as stress tests, scenario planning and counterparty exposure reviews.

Changes in policy and leadership at the Federal Reserve in 2014 add another level of complexity. Expectations of economic recovery, the tapering of the accommodative monetary policy and reduced market interventions have alternated with expressions of caution and continued easing. This uncertainty is fueling volatility in a range of markets, such as global emerging market debt and domestic municipal bonds.

Economic capital modeling and enterprise risk management tools are essential to survival in this uncertain environment. Economic modeling on a global basis is a necessary component of both investment and liability management as global economies become increasingly interdependent.

6. Prepare for escalation of governance and accountability

Regulatory pressures like solvency-focused initiatives, accounting changes and new federal oversight groups continue to intensify for insurers. Greater regulatory intervention, not less, is the trend. Insurers are tasked with committing resources to their Own Risk and Solvency Assessment (ORSA), the NAIC’s model law on governance, and to the accounting changes for insurance contracts that are necessary to align GAAP with international accounting standards. Moves by federal oversight bodies to introduce their own market-specific requirements are likely to create additional challenges. The burdens caused by regulatory change affect how companies organize data, choose technologies and implement processes.

Insurers have long faced a complex regulatory environment, but changes in recent years add layers of complexity. While regulatory initiatives are diverse in scope, common themes include the need for a clearer picture of enterprise risk, greater transparency of operational effectiveness and a focus on enhanced governance and accountability. Timing to implement these regulatory changes remains uncertain, and the real push to improve governance structures may come from within the insurance organization.

There is a developing need for detailed record-keeping and reporting capabilities relating to the specific characteristics of individual securities and securities transactions. This includes a thorough examination of funds and unit-linked securities, as well as measurement of concentration risk. While structured securities relating to credit default obligations and subprime mortgages were in focus during the 2008-09 financial crisis, new securities...
risks are emerging, such as synthetic investment portfolios, repurchase agreements and securitized insurance risks. These investment activities may invite substantial regulations as part of the development of rules governing systemically important financial institutions (SIFIs).

Insurers are expected to implement their ORSA frameworks in 2014 and their related reporting the following year. Solvency-focused regulations raise important questions about which internal processes need to be changed in risk governance and risk management. Insurers confront an immediate need to focus on data quality and data governance to meet the demands for more risk-sensitive measures and reporting.

Insurers must dedicate scarce financial and actuarial resources to other efforts, such as the converging guidelines for insurance contracts under US GAAP and IFRS. Implementation of the proposed FASB/IASB insurance contracts standard is the most significant change in the insurance industry in the past two decades. Under the new models, insurance contracts must ensure that incurred claim liabilities are discounted to reflect the time value of money. Re-projecting future cash flows at each reporting date requires detailed, accurate data and modeling, at a time when actuarial resources and systems may be strained.

The Federal Insurance Office (FIO) and the Financial Stability Oversight Council (FSOC) are also expected to pressure insurer resources. The FIO, established by the Dodd-Frank Wall Street Reform and Consumer Protection Act, has an objective of monitoring all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or in the US financial system.

Dodd-Frank is also responsible for the creation of the FSOC, charged with identifying risks to US financial stability presented by large, interconnected financial institutions. The FSOC issued its final rules on the designation of SIFIs in the spring of 2012 and designated three non-bank institutions (AIG, Prudential Financial and GE Capital) in June 2013. Insurers receiving the designation will be subject to both state-based regulation and federal regulation (by the Federal Reserve Board).

The complexity of cross-border supervision and regulation is a major challenge for multinational insurers. Broader designation of global systemically important financial institutions (G-SIFIs) or global systemically important insurers (G-SIIs) may result in a common standard for capital measurement and a common framework for capital regulation. The Basel, Switzerland-based Financial Stability Board, using IAIS assessment methodology, identified an initial list of nine G-SIIs, which includes three US companies – AIG, Prudential Financial and MetLife.

Certainly, as this report indicates, the trend is toward improved governance and risk management systems. For insurers, risk is the essential element of the business, and a clear understanding of it should be a business imperative.
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