Exploring the top 10 risks and opportunities faced by global insurance organizations
Executive summary

The Insurance Business Pulse report identifies the top 10 risks and opportunities faced by insurance organizations today and in the next few years, based on a survey of executives at 65 companies across the globe, representing both emerging and developed markets.

The findings make clear that insurance companies must adjust to the new environment of lower returns on assets and stricter regulation on everything from capital allocation to commission rates and customer care. In their search for growth, insurers are confronted with a shortage of skills, new threats, concerns about operational and reputational risk, and higher consumer expectations. Of course, the risks and challenges also represent opportunities for insurers to drive transformation and gain competitive advantage.

The results can be used as a roadmap for navigating significant challenges and a benchmark to guide strategic decision-making.

The key findings:

► Companies are renewing customer focus to meet demand — one individual at a time.

► Flexibility must be built into all aspects of the business to achieve cost competitiveness.

► Regulation could lead to more effective risk management and help bolster stakeholder confidence in the industry.
The *Insurance Business Pulse* survey identifies the top issues on the minds of insurance executives.

<table>
<thead>
<tr>
<th>Risk ranking</th>
<th>2013</th>
<th>2015</th>
<th>Opportunity ranking</th>
<th>2013</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic trends</td>
<td>1</td>
<td>2</td>
<td>Improved distribution and product development</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Regulation</td>
<td>2</td>
<td>1</td>
<td>Promoting fair outcomes for customers</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Eurozone debt crisis</td>
<td>3</td>
<td>4</td>
<td>Shifting sales to accommodate changing customer needs</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Reputational risk</td>
<td>4</td>
<td>8</td>
<td>More effective enterprise-wide risk governance</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Corporate governance failures</td>
<td>5</td>
<td>7</td>
<td>Growth in emerging markets</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Cyber-risk and data security</td>
<td>6</td>
<td>3</td>
<td>Re-optimizing capital structures and redesigning asset liability strategies</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Talent recruiting skills</td>
<td>7</td>
<td>5</td>
<td>Impact of global demographic changes</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Impact of tax and accounting changes</td>
<td>8</td>
<td>9</td>
<td>Personalization of medicine and insurance policies</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Operational risk</td>
<td>9</td>
<td>13</td>
<td>Exponential growth of data and analytical tools</td>
<td>9</td>
<td>6</td>
</tr>
<tr>
<td>Availability and cost of capital</td>
<td>10</td>
<td>6</td>
<td>Rise of social media tools</td>
<td>10</td>
<td>9</td>
</tr>
</tbody>
</table>

*Business model innovation is number 10 risk in 2015*
The top risks and opportunities can be organized around four key drivers of growth identified by EY’s *Growing Beyond* program.

**Cost competitiveness**

*Working with less*

Since the 2008 fiscal crisis, obtaining capital has been more difficult — presenting stark choices and making cost competitiveness a market imperative. Tomorrow’s winners will be those that have clear strategies regarding capital-structure optimization and asset liability.

**Customer reach**

*Meeting demand one individual at a time*

The fiscal crisis limited the ability of insurers to reach customers and dampened overall demand. However, the prospects are bright for companies that can revamp distribution and communications channels. “Re-launching the brand” will allow insurers to reach new consumers as household incomes grow in developing markets and engage new segments in mature markets.

**Stakeholder confidence**

*The right response to risk*

Increasing regulation challenges insurers but also presents opportunities to establish more effective risk management through effective enterprise-wide governance and also bolster the confidence of stakeholders. That’s a crucial point as insurers develop new products aimed at consumer segments unfamiliar with purchasing insurance.

**Operational agility**

*Keeping one step ahead*

In the current environment, predicting and reacting to change can be a major source of competitive advantage. However, insurers must have a realistic sense of their agility to better gauge their appetite for variability and risk. The more agile a firm is, the more comfortable the board can be with strategies affected by changing conditions.
The risk and opportunity Radar

At the center of the radar are the risks and opportunities identified by survey respondents as having the biggest impact on major organizations worldwide.
Where the risk is

The insurance sector needs to adjust to a new environment.

- Macroeconomic trends
- Eurozone debt crisis
- Operational risk
- Reputational risk
- Cyber-risk and data security
- Impact of tax and accounting changes
- Availability and cost of capital
- Corporate governance failures
- Regulation
- Macroeconomic trends
- Eurozone debt crisis
- Reputational risk
- Cyber-risk and data security
- Talent recruiting skills
- Operational risk
- Regulatory changes
- Cost competitiveness
- Customer reach
- Stakeholder confidence
- Operational agility

2013 ranking and expected 2015 ranking

- Up in 2015
- Same in 2015
- Less in 2015
Where the opportunity lies

Growth opportunities are within reach for companies that improve customer reach, rethink risk management and embrace data innovation.

- Improved distribution and product development
- Re-optimizing capital structures and redesigning asset liability strategies
- Shifting sales to accommodate changing customer needs
- Exponential growth of data
- Impact of global demographic changes and analytical tools
- Promoting fair outcomes for customers
- More effective enterprise-wide risk governance
- Growth in emerging markets
- Personalization of medicine and insurance policies
- Rise of social media tools
- Exponential growth of data and analytical tools
- Impact of global demographic changes

2013 ranking and expected 2015 ranking

- Cost Competitiveness
- Customer Reach
- Stakeholder Confidence
- Operational Agility

Insurance Business Pulse
Imperatives for insurers

Meet customer need for coverage

Address regulatory changes across geographies

Seize the fee-for-service opportunity

Maximize customer profitability

Macroeconomic trends
Flat interest rates and financial market instability

The slower pace of growth in many markets affects insurers’ ability to provide coverage at an acceptable rate of return — as well as consumers’ need for coverage. Macroeconomic trends are the top current risk because they fundamentally distort efforts to identify, differentiate and retain new customer groups.
Insurance companies have been preparing for the far-reaching impacts of Solvency II for several years. The directive — intended to standardize the European insurance market by aligning regulations across the borders of EU member states — will provide greater global coordination of regulation. But it also presents a potentially difficult transition as companies must implement substantial changes to meet SII requirements.

**Solvency II**
- Potential for worldwide impact in insurance
- Uncertain implementation date
- Risk of delay to 2015 because of European Parliament action on Omnibus II

**Imperatives for insurers**
- Adjust equity portfolios
- Manage compliance costs
- Keep customer focus
#3 Eurozone crisis: global concerns
The Eurozone debt crisis is both a consequence of the recent financial downturn and a potential trigger for future uncertainty.
- 0.1% contraction of EU GDP in 2013
- Governments “muddling” through
- High unemployment
- Consumer skepticism toward financial institutions

#4 Reputational risk: caught in the crossfire
Multiplying regulations mean a greater chance of non-compliance, leading not only to fines and sanctions, but also to the perception of lax ethics. The stakes are high as a lack of trust and reduced loyalty among customers and shareholders can have severe consequences for insurers.

**Imperatives for Insurers**
- Seize opportunities to build loyalty
- Enhance cross-selling capabilities
- Cultivate transparency and two-way consumer communications
Corporate governance failures:
The need to maintain trust

The fallout from the financial crisis has led to a rise in shareholder activism and a sense that complying with the letter of the law is not enough. Though there have been few examples of corporate governance failure in insurance (especially compared to banking), the central issue of trust remains critical to insurers.

**Imperatives for insurers**

- Rethink executive compensation
- Focus board on shareholder interests
- Make compliance function a proxy for regulators

Cyber-risk/data security: containing growing threats

Sophisticated hacking tools, the rising threat of state-sponsored attacks, and concerns about mobile app security are among the reasons cybersecurity will be a top-three risk by 2015. The intense focus on digital channels requires insurers to protect personal data.

**Imperatives for insurers**

- Recognize threats as strategic risks
- Look beyond IT impacts
- Align board, CROs and CIOs
Talent: attracting skills and retaining knowledge

Cybersecurity and risk management. Technical and math skills. Analytical and modeling abilities. Leadership, customer experience and sales strategies. Insurers must address significant gaps in their current talent base, while retaining existing expertise. Add to that a critical shortage of actuaries, significant and unique recruitment issues in developing markets, and it’s no wonder that talent-related issues are moving up the risk agenda of senior leaders.

**Imperatives for insurers**
- Attract younger more tech-savvy work force
- Retain existing expertise and institutional knowledge
- Optimize incentive compensation

Impact of tax and accounting changes

Systemic regulatory overhauls across the industry could have a substantial impact on insurers’ cost competitiveness — a good example of “known” risks. However, uncertainty persists about the coordination of standards across jurisdictions.

**Imperatives for insurers**
- Maintain customer focus
- Coordinate compliance efforts
- Streamline and automate reporting processes
Operational risk: new capabilities required

There is new urgency to quantify risk to meet new regulatory demands regarding consumer protection and to establish positive feedback loops in operational risk management, so that there is transparency into impacts on capital requirements.

New capabilities required:
- Risk quantification
- Efficient compliance processes
- Scenario planning and stress testing
- Risk-informed decision making
- Visibility into IT risk

Availability and cost of capital: How to attract investors?

To remain cost competitive, insurers need to adapt business models to the slower-growth environment — an imperative likely to increase in importance by 2015. The industry’s enforced shift away from asset-based income streams has had a considerable impact on attracting investors. Income generated by fee-based services will be subject to fluctuations within the wider economy.

Imperatives for insurers
- Engage regulators and industry associations
- Communicate with investors
- Model revenue shifts
New technology can power game-changing innovations.

Opportunities

#1 Opportunity

Improved distribution and product development

Have online research and price comparison sites replaced the agent and broker once and for all? Is personal interaction dead? No, but they have forever changed product development and distribution. The creative use of products and distribution techniques can change customer behavior. Effective collation and analysis of data can enable carriers to perceive and target demand for new products, control the customer experience and manage costs.
Promoting fair outcomes for customers

Consumers want and expect to trust their insurance companies. That’s why carriers must embrace the underlying principles behind fair outcomes, rather than just “checking the box” of compliance. Solvency II and other new regulations will help boost consumer confidence and attract investors. But companies that focus on treating customers fairly are ahead of the curve with both customers and regulators in instilling stakeholder confidence.

As regulatory scrutiny increases, trust remains a source of competitive advantage.
Shifting sales to accommodate changing customer needs and a fast-changing world

It’s all about speed and agility if sales and marketing programs are going to detect and deliver against shifting customer sentiments. Firms that can integrate customer research, product development and sales strategy and streamline decision-making processes will gain competitive advantage and new revenue streams as investment income shrinks.

Fierce competition means the industry must become customer-friendlier.

More effective enterprise-wide risk governance

Regulators, customers and other stakeholders need assurance that insurers understand their risk exposure and know how to minimize it. Regulators want to know that insurers have enough capital on hand and strong internal processes to manage risk. That’s why the board must play a key role in improving enterprise risk management (ERM).
Growth in emerging markets (especially the middle class)

A major geographic shift is underway in the balance of consumer purchasing power.

# of households earning above US$30,000 in 2020

<table>
<thead>
<tr>
<th>Market</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging markets</td>
<td>149 million</td>
</tr>
<tr>
<td>US</td>
<td>120 million</td>
</tr>
<tr>
<td>Eurozone</td>
<td>16 million</td>
</tr>
</tbody>
</table>

Pensions and life insurance opportunity:
by 2050, over 30% of China's population and 20% of India's population will be over the age of 60.

Re-optimizing capital structures/
redesigning asset liability strategies

For insurers struggling with the cost of capital in the current macro environment, improving both structure and strategy is essential. The aging of the baby-boomer generation has serious capital expense implications. After years of generating revenue, the industry faces a long period of payouts, even as the younger generation contributes less to retirement savings.

The CRO, CFO and CIO must collaborate to create organizational understanding of investment opportunities, asset risk and risk-reward balance on yield.
Impact of global demographic changes

Aging populations present the industry with both challenges and opportunities that necessitate multi-layered thinking about market segmentation, operational impacts and other factors.

Long-term demographic shifts have short-term implications

- Shortage of nursing homes in China
- Rise of private long-term insurance in Japan
- Growth of Takaful (Islamic insurance)

Personalization of medicine and insurance policies

The completion of the Human Genome Project sparked a new discussion about the future of the healthcare and insurance industries. Truly personalized medicine and the shift from a one-size-fits-all mentality can shift how insurers engage with customers and design coverages. Privacy and ethical issues loom large, but the game-changing potential is real.
Exponential growth of data and availability of advanced analytical tools

As the cost of digital storage and processing power has dropped, customer data volumes have exploded. The best results are achieved by asking the right questions; analytics should be viewed as a creative, customer-facing enterprise — rather than an unwieldy IT initiative. The most successful insurers will be those that use data and analytics to design new products and personalize the customer experience to address the perennial challenges of low loyalty and high acquisition costs.

Analytics enable personalization as seen in many industries

A new skill for carriers to master — reaching customers in 140 characters or less

Rise of social media tools for distribution or collaboration

Twitter and Facebook will never completely replace face-to-face interaction, but social media can be used to communicate more directly and personally with consumers. Plus, it can improve the speed and scope of internal communication and contribute to operational flexibility.
Learn more

Global Insurance Leader
Shaun Crawford
+44 207 951 2172
@ShaunCrawfordEY

Download the full report >
www.ey.com/insurance/business-pulse
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY’s Global Insurance Center
Insurers must increasingly address more complex and converging regulatory issues that challenge their risk management approaches, operations and financial reporting practices. EY’s Global Insurance Center brings together a worldwide team of professionals to help you succeed — a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant sector issues. Ultimately it enables us to help you meet your goals and compete more effectively.

© 2013 EYGM Limited.
All Rights Reserved.

EYG no. EG0128
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com