2015 US life-annuity insurance outlook

Market summary

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

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

New players are developing new business models and market approaches to better align with customer expectations.
In 2015, distribution priorities will continue to focus on expanding market opportunities. While the high-net-worth market drives sales and attracts distributor attention, the financial protection and savings needs of the middle-market remain underserved. The challenge for insurers is to execute an efficient middle market strategy, without disrupting the industry’s high-net-worth mainstay.

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

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

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

External forces in 2015

<table>
<thead>
<tr>
<th>Interest rates and economic factors</th>
<th>Consumer confidence</th>
<th>Customer needs</th>
<th>Technology changes</th>
<th>Regulations</th>
<th>Capital adequacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slight interest rate rise; still near low; slow economic growth</td>
<td>Confidence improving</td>
<td>Needs and expectations increasing</td>
<td>Pace of change dramatic</td>
<td>Steady increase and new regulators appearing</td>
<td>Capital rebuilt, continued accumulation and new entrants</td>
</tr>
</tbody>
</table>

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US life-annuity insurers that better understand and accept these forces of change are in a position to seize competitive opportunities by modernizing their products, services, operations and distribution.

Specifically, successful insurers in 2015 will:

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

Reposition distribution strategies to expand market opportunities

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

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

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

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

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

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

Embrace digital as the new storefront

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

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

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

Develop simplified products to expand customer markets

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

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

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

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

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

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

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

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Figure 3: Household financial assets

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

<table>
<thead>
<tr>
<th>Household Segment</th>
<th>Life and annuity's percent of financial assets by household segment 2013 (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High net worth</td>
<td>3.8</td>
</tr>
<tr>
<td>Mass affluent</td>
<td>6.3</td>
</tr>
<tr>
<td>Middle market</td>
<td>7.4</td>
</tr>
<tr>
<td>All other</td>
<td>7.8</td>
</tr>
</tbody>
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*Cash value life insurance, excludes term

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

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

Enhance data security

Data security has long been a major concern for insurers and other companies that handle sensitive customer personal information. Newer IT practices, such as cloud computing, have exposed insurers to additional technology security risks, despite the operational value.

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

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

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

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

Adjust to new competition from alternative capital sources

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

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

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

Proactively address the uncertain regulatory environment

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

A case in point is the regulatory differences in capital and systemic risk. Some large life insurers have been designated systemically important financial institutions (SIFI) by the Financial Stability Oversight Council in the US, while these and other internationally active life insurers also have been designated global systemically important insurers (G-SII) by the Financial Stability Board. Although the designations were originally announced in 2013 and continue to be updated, it remains unclear if there will be additional regulatory expectations for SIFIs or G-SIIs. Other solvency and capital issues have been raised, especially regarding the use of captives by life insurance companies.

The regulatory bodies are also under
pressure. Consequently, regulators have increased their demands for information from insurers and are more apt to closely scrutinize submissions. Insurers are caught between competing forces. Regulatory competition exists at all levels — state regulators, national regulators and international regulators are all exercising their respective points of view.

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

Doug French
+1 212 773 4120
doug.french@ey.com

Kaenan Hertz
+1 212 773 5988
kaenan.hertz@ey.com

Dave Czernicki
+1 312 879 3666
dave.czernicki@ey.com
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