2017 European insurance outlook
European insurers will find themselves at a crossroad in 2017. External challenges, financial volatility and increased competition will continue to weigh on income streams and consumer demand. But insurers will also have an opportunity to capitalize on technological innovations and changing consumer preferences to safeguard their future success.

Against a backdrop of political, economic and regulatory change, European insurers will need to rethink their strategies, products and business models to stay relevant in a fast-evolving market. In 2017, insurers should think ahead to 2020 and prepare for a transformed marketplace.
Europe faces weak growth in 2017. New political pressures could slow the recovery, raising the risk of lower business flows and weaker persistency rates for insurers. Loose monetary conditions, nagging unemployment and low wage and income growth will also challenge the sector by depressing savings. Tighter government budgets coupled with longer life expectancy will drive demand for retirement and health products, while increasing insurers’ indemnity costs and risks.

The sterling and the euro devalued against the dollar after the Brexit vote. Equity markets also experienced increased volatility, which is likely to continue in 2017 as Brexit terms are clarified. Continued financial market instability will put stress on Eurozone insurers’ investment and capital positions, potentially leading to ratings downgrades for insurers and counterparties. It could also affect merger and acquisition activity in 2017 as struggling firms become easier targets for acquisitions and middle-market firms continue to merge to improve competitiveness.

These new stresses compound the most critical post-crisis macroeconomic challenge for the insurance sector – low interest rates. Long-term rates across Europe are expected to stay low, weighing on capital positions and earnings. General insurers’ ability to respond through repricing, efficiency savings and investment strategies will stay under pressure in 2017.

Life insurers are even more vulnerable, given the proportion of guaranteed products in their back-office books and levels of interest rate sensitivity in their business mix. European life insurers have maintained a prudent investment stance in recent years.

### Average asset allocations*

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>Bonds</td>
<td>73.8%</td>
<td>74.8%</td>
<td>74.1%</td>
<td>73.9%</td>
<td>74.1%</td>
<td>73.6%</td>
</tr>
<tr>
<td>Equities</td>
<td>5.9%</td>
<td>5.0%</td>
<td>5.1%</td>
<td>6.0%</td>
<td>5.8%</td>
<td>5.9%</td>
</tr>
<tr>
<td>Private equity</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Hedge funds</td>
<td>0.4%</td>
<td>0.3%</td>
<td>0.3%</td>
<td>0.3%</td>
<td>0.3%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Property</td>
<td>5.8%</td>
<td>5.8%</td>
<td>5.9%</td>
<td>5.9%</td>
<td>5.5%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Mortgage loans</td>
<td>2.8%</td>
<td>2.7%</td>
<td>2.7%</td>
<td>3.2%</td>
<td>3.0%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Other loans</td>
<td>0.6%</td>
<td>0.5%</td>
<td>0.6%</td>
<td>0.8%</td>
<td>1.2%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>7.2%</td>
<td>7.5%</td>
<td>7.8%</td>
<td>6.8%</td>
<td>6.7%</td>
<td>6.8%</td>
</tr>
<tr>
<td>Other assets**</td>
<td>2.9%</td>
<td>2.8%</td>
<td>2.9%</td>
<td>2.5%</td>
<td>2.7%</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

*E = Estimate

Source: Standard & Poor’s (S&P).

* In S&P sample.

** Ceding company deposits and hedging assets.
years. But appetite for higher-yielding, long-dated investments (e.g., real estate, infrastructure and infrastructure debt), overseas investments and alternative asset classes (e.g., private economic and hedge funds) is likely to grow in 2017.

Such investment strategies will be most viable for the largest players, or those with specialist investment focus, and are likely to remain a modest part of firms' overall investment portfolios. Regulatory changes that reduce risk charges for equity investments into higher-quality infrastructure corporates will make them still more attractive. Shifts into infrastructure and other "socially useful" asset classes are likely to continue to receive both political impetus and support from shareholders.

Brexit and the globalization backlash

In 2017, Brexit is expected to have a limited direct impact on insurers. For UK firms, the Lloyd's market and global players with sizable UK interests, Brexit will prompt management teams to reassess European Union (EU) operations. But restructuring costs are expected to be marginal, and the organizational changes could offer strategic advantages. For EU insurers, Brexit may provide opportunities for firms with investments denominated in sterling and give them greater access to talent if expatriate employees relocate back to the continent.

Existing and incoming regulations will help passport-like conditions remain open to UK firms conducting business in Europe (via provisional Solvency II equivalence and third-party rights granted through the Markets in Financial Instruments Directive (MiFID) II from 2018). And the International Association of Insurance Supervisor's (IAIS's) use of Solvency II as its baseline for international capital standards will also support equivalent treatment for EU firms operating in the UK and vice versa.

Of greater concern is whether Brexit represents the start of a global wave of economic nationalism and populism that could hurt businesses in Europe. According to economist Dr. Nouriel Roubini: "Brexit is the proverbial canary in the coal mine, signaling a broad populist and nationalist backlash - at least in advanced economies - against globalization, free trade, offshoring and labor migration. The rise of populism is a particular cause for concern in European states whose governments are up for election in 2017. Increased political risk in economies long considered bastions of political stability could affect the risk-free rate and cause further bifurcation in European government bond markets, potentially reviving the euro crisis and raising the risk of an EU breakup scenario."

More nationalistic economic policies under Trump could also have a significant impact in Europe. A rise in US trade protectionism could dampen the growth of European markets and their trading partners, and increase currency and market volatility. But if US corporate taxes are cut, insurers could benefit via higher growth and long-term interest rates in the US.
Adjusting to regulatory complexity

In 2017, insurers will grapple with the implementation of Solvency II, while preparing for wider regulatory change. Firms will continue to adjust business processes and strategies. Pressures on compliance and risk functions will remain high.

Preparation for International Financial Reporting Standards (IFRS) 17 will begin in 2017. This new standard on accounting for insurance contracts will have far-reaching implications for the way insurers manage the liability side of their balance sheets. While the implementation period is relatively long, work streams to develop an effective operational and strategic response will get under way in 2017.

Internationally active insurance groups (IAIGs) and global systemically important insurers (G-SIIs) in Europe will need to gear up for the IAIS’s Insurance Capital Standard (ICS), scheduled for 2020. In 2017, this will involve confidential reporting of ICS Version 1.0, an exercise that will enable European groups and supervisors to improve their understanding of Solvency II group capital frameworks and the ICS.

Preparation for the 2018 transposition of the Insurance Distribution Directive (IDD) into national laws will continue. These new standards will help insurance firms improve the quality and transparency of information provided to consumers, while increasing transparency across distribution.

Increased regulatory oversight of cybersecurity risks is on the agenda in 2017. The 2016 directive on security of network and information systems includes the requirement that firms take appropriate security measures to protect against cyber risks and report serious breaches to national authorities within 72 hours. From 2018, firms that fail to meet the requirements will be subject to penalties of up to 4% of revenues and open to private lawsuits. EU data protection rules are already more stringent than in other regions, and these new concerns around cyber risk and national security can be expected to lead to a greater focus on cybersecurity.

Politics could also affect the regulatory stance in key markets. If the new US Administration deregulates, this could trigger a “race to the bottom” in other markets fighting to stay competitive. Areas where EU regulation is less harmonized (e.g., conduct) could also be affected if individual EU governments see stringent regulations on consumer protection and market integrity as holding back growth in financial markets.
Rising digital expectations and innovation

In 2017, European insurers will be expected to meet rising customer expectations for digital access and transparency, particularly for car and household insurance. Insurers will need to concentrate on millennials because of their rising wealth and growing influence over other generations.

Digital innovations will continue to drive change across the insurance value chain – from product development and underwriting to back-office operations and online distribution. Social, mobile, analytics and cloud (SMAC) technologies will become utility assets in 2017, as forward-looking insurers turn their attention to smarter technologies, such as artificial intelligence (AI), blockchain and the internet of things (IoT), to leap ahead of competitors. In 2017, insurers will go beyond experimentation and develop use cases and practical applications for new technologies. For example, insurers hope that the IoT will provide a huge store of real-time, actionable information that they can use for actuarial risk assessment and product development.

In 2016, InsurTech gained traction in the marketplace. To take advantage, insurers invested in InsurTech through venture capital (VC) funds and strategic partnerships. The rise of Insurtech will pressure insurers to accelerate innovation and make further acquisitions and alliances in 2017. While digital challengers will remain reliant on established players for product underwriting and distribution, the consumer appeal of their products is likely to grow. This could increase complexity in the way products are brought to market.

As the use of digital technology becomes pervasive, cyber risks will multiply for insurers. This is particularly true for an industry where autonomous cars, health monitoring devices and smart homes will eventually become the norm. Insurers’ legacy systems built on unpatched and outdated software will be highly vulnerable to cyber attacks. Interactive technologies, such as telematics, wearables and the IoT, will provide cyber criminals with new routes to highly sensitive personal data. In 2017, the cost of large-scale breaches will loom larger when the full range of operating, reputational and regulatory risks is considered.

To stay in front of digital change, insurers will need ready access to a range of technical expertise, from digital marketing to predictive analytics. As organizations re-platform their businesses and staff retires, insurers will focus more on the future of work, taking into account the tasks to be handled by machines or people.

Demand for cyber insurance is growing in Europe. Cyber risk is now covered across various overlapping errors and omissions (E&O) policies, leading to complicated claims procedures and a scramble among providers to clarify exemptions. Once proper pricing models are developed, cyber insurance will become a vibrant business opportunity for insurers.
### Impact of external factors on the European insurance markets in 2017
(1 = low impact, 10 = high impact)

<table>
<thead>
<tr>
<th>Factor</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy and politics</td>
<td>Low interest rates will remain the biggest challenge for European insurers, especially those with high levels of guaranteed products on their back-office books. Political shifts in Europe and the US could slow economic recovery and increase financial market volatility.</td>
</tr>
<tr>
<td>Regulation</td>
<td>Insurers will need to address new regulations, including IFRS 17, the implementation of the IAIS’s ICS, the transposition of the IDD into national law, and EU cyber regulations.</td>
</tr>
<tr>
<td>Customer expectations</td>
<td>Customer expectations for digital access and transparency are rising, particularly for car and household insurance. The growing wealth and influence of millennials, combined with the rise of InsurTech, will require insurers to rethink their go-to-market strategies and improve cross-channel customer experiences.</td>
</tr>
<tr>
<td>Cyber risk</td>
<td>Rising use of interactive technology, together with new regulations on data security, will throw a spotlight on cyber risk in 2017. Legacy systems of insurers and their distributors built on outdated software may be particularly vulnerable to cyber risk. More insurers will eventually step in to meet growing demand for cyber risk insurance.</td>
</tr>
<tr>
<td>Technology</td>
<td>Advances in technology will enable insurers to find greater internal efficiencies and develop new products, business models and distribution channels. Insurers will turn their attention to smarter technologies, such as AI, the IoT and blockchain, which will enable them to accelerate digital transformation.</td>
</tr>
<tr>
<td>Competition and M&amp;A</td>
<td>The strategic implications of changing regulations and increased competition from new entrants will likely drive greater market consolidation and restructuring. Insurers will continue to explore the application of InsurTech across the value chain and will increase their focus on strategic partnerships, acquisitions and VC investments.</td>
</tr>
<tr>
<td>Talent</td>
<td>Regulatory and technological shifts will leave insurers with wider talent gaps, from data scientists to digital marketers. Insurers will need to develop workforce strategies that consider the future of work. These strategies should address the possibility of increasing barriers on the free cross-border flow of talent.</td>
</tr>
</tbody>
</table>
Strategic road map for 2017
The interplay of economic, political, regulatory and market shifts will reset strategic imperatives for European insurers in 2017. In a fast-evolving environment, insurers will need a clear vision of the future, and how best to position their firm for sustained long-term success in a very different marketplace. Management teams will want to challenge their current three-year plans by asking themselves big strategic questions: what major market shifts and scenarios should we prepare for? What will these changes mean for our business? Are there product lines and markets we should exit? How will we need to rethink our distribution channels and operating and cost models? Which new technologies should we embrace? What talent will we need to capture our future?

This paper provides a strategic road map for 2017 to help executives come to grips with the challenges ahead.

1. Reboot your business plans to prepare for market transformation
2. Tailor product and investment strategies to challenging market conditions
3. Make customers the center of gravity
4. Take digital transformation to the next level
5. Attract, develop and retain talent
Revisit your three-year plans and challenge conventional thinking. In 2017, management teams will need to take bold strategic bets to position themselves for success in 2020 and beyond. Because of the high degree of uncertainty, it will be important to assess what future market shocks - such as a possible breakup of the EU - will mean for your business. “Insurers will manage several high-risk scenarios by hedging against them,” says Shaun Crawford, EY Global Insurance Leader. “But you also need to make smart strategic bets. Having the board’s agreement on the future vision will be critical for setting out strategies to get you there by 2020.”

Prepare for greater market uncertainty. As insurers have found in 2016, macro shocks are increasingly unpredictable. In 2017, post-Brexit political changes in Europe, a new Trump Administration in the US and continued economic pressures will inject even greater uncertainty into the marketplace. Because of the higher degree of uncertainty, insurers will need to draw more on predictive analytics to improve their understanding of the potential impact of alternative scenarios on interest rates, customer demand and other market conditions. Setting up early warning systems, preparing contingency plans and building resiliency into business strategies will be critical for success.

Develop strategies for a changing competitive landscape. Reassess capital and compliance costs, growth opportunities and competitive advantages. Where organic growth potential is limited, consider M&A and tie-ins with InsurTechs to build expertise and scale. Strengthen customer relationships through innovation and proactive retention strategies to mitigate growing competition from new entrants. Larger players should explore strategic sales, acquisitions or partnerships that could reinforce core competencies or offload underperforming businesses. Where current structures are holding back new product or market initiatives, consider setting up new entities or spinning off parts of the business to a JV or partnership. The ability to act quickly will be key to competing effectively in the coming years. Assess the post-Brexit competitive landscape and develop strategies to consolidate or grow market share where the existing balance of players may change.

“Insurers may want to throw away their three-year plan and come up with a strategy that embraces market transformation. CEOs need to disrupt their businesses now, before the market does it for them.”

Shaun Crawford, Global Insurance Leader, Ernst & Young LLP
Tailor product and investment strategies to challenging market conditions

Gear strategies to a continuation of low interest rates. Prioritize investment strategies that bolster profits without substantially raising the firm’s risk profile. Rebalance the share of risk between the firm and the policyholder (e.g., diversify into the unit-linked asset management business, de-emphasize guaranteed rates and promote protection products). At the same time, maintain a focus on managing costs and back-office book procedures to assess the viability of guaranteed product lines. In markets such as motor insurance, consider building up usage-based offerings—a strategy that could reduce distribution costs and claims while catering to changing consumer preferences.

Seek out areas to build market position. Step away from the compliance-driven direction of change that has dominated the last few years and take stock of which areas of the business offer poor profits or are becoming less competitive. To cut costs and free up funds for product innovation, emphasize areas where your firm can carve out a leading market position; move away from underperforming products that have no clear upside in sight. Start looking at areas where demand for insurance can be expected to grow, especially where government funding is limited and risks are rising, e.g., natural disaster and cyber attacks. Focus more heavily on socially responsible investing to meet the rising expectations of shareholders and policy-makers.

Develop resilient investment strategies. Continue to develop robust investment strategies, with clear exit or mitigation plans. Gauge the impact of changing market dynamics and lower valuations on non-traditional asset portfolios (e.g., real estate allocations in the event the market falls or the investor mix changes significantly). Capitalize on equity and currency volatility resulting from heightened political uncertainty. Stress test portfolios to maintain resilience against a scenario of ongoing low rates and asset price declines (a possibility in 2017, given elevated levels of political risk) or a rise in interest rates (including implications on higher credit spreads on credit risk exposure and longer durations in portfolios). Pay attention to effects of Solvency II on capital needs and assess where asset allocation optimization or reinsurance may help drive down capital needs.

“Insurance leaders are desperately trying to simplify their businesses to reduce costs and meet customer needs. They are looking at everything—from systems to process to regulatory frameworks to customer experiences.”

Peter Manchester, EMEIA Insurance Advisory Leader, Ernst & Young LLP
Make customers the center of gravity

Harness technology to stay on top of fast-changing customer needs. To get a fuller picture of the customer, insurers should integrate data scattered across their organization, drawing on data held by agents and available through open sources. Take advantage of advanced analytics – from micro-segmentation and demand sensing to predictive modeling and behavioral analysis – to understand shifting customer behaviors and expectations fully. Experiment with newer technologies, such as AI, wearables and the IoT, as valuable sources of customer insight. To meet customer expectations, develop internal systems and processes that step up to EU packaged retail and insurance-based investment product (PRIIPs) and IDD requirements.

Strengthen customer engagement through new product and marketing initiatives. Continue the evolution from a product- to a customer-centric approach by building interaction with customers. Devise more points of contact with customers throughout the product life cycle, especially for long-running policies such as life insurance. Use new technology, such as telematics, social media and gamification, to stimulate consumer engagement. Offer consultative risk services on the commercial side, e.g., non-insurance offerings for cyber risk with a focus on reducing rather than indemnifying the risk of cyber losses. Take a holistic approach to upselling or cross-selling services to existing clients, creating a more user-friendly and seamless cross-channel experience for customers and insurance agents. According to Peter Manchester, EY EMEIA Insurance Advisory Leader, “Creating an effective customer relationship is less about intimacy and personalization, and more about ease of access, ease of contact and ease of fulfillment.”

Millennial-proof your business. A sharper focus on millennials is essential due to their rising income and influence over market buying behaviors. To meet the needs of millennials, insurers should provide digital, mobile-first access, 24/7 customer service and a seamless, cross-channel experience. Simplifying the customer journey from the initial contact to the claims process and putting innovation at the center of business strategies will be critical. Explore product propositions geared to changing millennial lifestyles. This will include rethinking products and pricing for a generation that may delay starting a family and may be more inclined to share assets than own them.

“Millennials will not accept the traditional way of selling. They will not want an agent to come to their living room to explain insurance. They will want to do that on their computer or smart phone. Getting this right over the next 12-24 months will determine a firm’s future success”

Dr. Andreas Freiling, EMEIA Insurance Leader
Ernst & Young LLP
**Take digital transformation to the next level**

**Shift your digital goal from cost-savings to revenue generation.** For insurers, digital transformation is no longer about gaining efficiencies, it is now needed to stay competitive, attract and retain customers, and grow the top line. But with costs under tight control, finding the right time to invest in a new digital platform can be challenging. “It’s not just an efficiency play; it’s an affordability play,” says Manchester. “It’s the recognition that you are going to have to invest across the whole digitally enabled customer experience while facing reasonably tight capital, low interest rates, a static cost base.” In 2017, insurers will want to set up agile IT development programs that are not only cheaper and faster, but that are timed so that cost-savings can be reinvested in re-platforming.

**Position your firm to be a winner in the 2020 digital marketplace.** In 2017, SMAC technologies will become table stakes as insurance companies turn their attention to newer, game-changing technologies, such as AI, the IoT, wearables, genomics and blockchain. In 2017, insurers should be developing use cases for these next-generation technologies, focusing on which ones will help them reinvent their business strategy and improve decision-making. At the same time, they will need to build up InsurTech capabilities through acquisition, partnerships or greenfield investments.

**Make cybersecurity a top imperative.** With the risk of cyber attacks rising and regulations upping the stakes, system security will be a key priority for 2017. Insurers will need to develop robust cybersecurity strategies with clear governance and accountabilities, including processes for detecting, reporting and responding to cyber risk. Eliminate vulnerabilities in legacy IT systems, including those used by agents and brokers. Establish a security strategy that keeps pace with digital transformation; for example, companies that use cloud technologies to store sensitive data should increase security measures proportionately. In addition to internal systems, commercial insurers will need to develop cybersecurity capabilities, solutions and services to support their clients. This will include creating compelling cyber protection products for the key sectors highlighted in the new EU cyber directive (energy, transport, water, banking, financial market infrastructures and health care), teaming with these industries where possible. At the same time, insurers will need to clarify exclusions on existing E&O policies.
Attract, develop and retain talent

Develop talent for a transforming marketplace. As technology adoption in the industry gathers pace, insurers will need to reassess workforce strategies to ensure relevant skillsets are being developed at different levels of the business. High on the priority list should be developing or acquiring familiarity with new technologies, such as the IoT, wearables and blockchain, as well as new forms of advanced analysis, such as scenario modeling, predictive analytics, AI and behavioral research. Consider the overall impact of technological innovations on job profiles. Develop programs to train existing staff on digital technology. Seek out new digital, risk and analytical talent. Work with higher education providers to attract university graduates to the industry – this is especially important as a swathe of industry leaders reach retirement age. Manage the transfer of knowledge between older and younger staff to bring together insurance experience with technological prowess.

Develop effective post-Brexit talent strategies. European insurers may want to devise strategies to attract UK talent affected by Brexit changes. At the same time, UK insurers may need to devise plans to deal with potential increased competition for talent from other European insurers and offshore jurisdictions such as Bermuda and Guernsey. Consider using M&A strategies to bring in talent and knowledge in areas where performance is below industry norms. Brexit may just be the beginning of a broader backlash against globalization, which could gain traction in other European markets and the US. Monitoring these trends and what they will mean for the free flow of talent and outsourcing will be important in 2017.

The underwriter of the future
In the future, underwriters will have a very different role, requiring different skills and mindsets, according to EY’s Crawford. “They will graduate from modeling to more advanced analytical tools. Tomorrow’s actuaries will need greater technical skills to interpret large sets of data from multiple sources. And they will need creative minds that can turn data into innovative products, new pricing formulas and better claims management.”
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