

# CEO Briefing 2014: The Agenda for Insurance



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Written by:

The Economist

Intelligence Unit

The CEO Briefing 2014 is an Accenture report, written by The Economist Intelligence Unit to provide a blend of macro-economic, geo-political and global business insights. The report analyzes the views of more than 1,000 C-suite executives – including 86 from the insurance sector – on prospects for the global economy and their companies, and defines how digital technology is transforming industries and changing the way business operates.



| looking  
| ahead

# CEO Briefing 2014: The agenda for insurance

Emerging from the difficult environment that has characterised the past few years, insurers are cautiously optimistic. In The Economist Intelligence Unit's survey for *CEO Briefing 2014*, insurance executives share the confidence of their peers regarding the prospects for the global economy, their home country and their own industry.

"I'm confident we have a few good years ahead of us with regard to the economy, and that will be helpful to the insurance industry," states Kurt Karl, chief economist at Swiss Re, one of the world's biggest reinsurers.

Moreover, insurers are slightly more optimistic about their own organisations than both their global peers and their colleagues in the banking industry (79% versus 76% overall and 74% in the banking sector) (Figure 1).

For some, the next 12 months will certainly bring new opportunities. Robert Benmosche, president and CEO of American International Group (AIG), a multinational insurance company, is among those who are upbeat on their firm's prospects. "Global demand looks strong, and right now we're seeing demand for new products and geographical expansion

overlapping in many ways," he says. "We see some opportunities, for example, to integrate life coverage into our consumer business on the property and casualty side."

However, the path forward will not be easy, with continued low yields on investments, price pressure on premiums, and a rise in the frequency and severity of extreme weather events. Moreover, the industry must tackle these issues in the face of numerous new and proposed regulations demanding change and a reshaping of the business models of a traditionally conservative industry.

The good news is that a boost to profitability may be on the cards as interest rates begin to rise. Given that the industry generally makes a small profit or only breaks even on underwriting and tends to make money on its ability to take long-term investment positions, the

gradual move away from historically low interest rates will likely bring good news for the sector's revenues.

"But unfortunately in the short run we end up reinvesting in lower yields," says Mr Karl. "So the big strain on the insurance industry is simply the inability to get higher yields from high-quality assets, which dampens profitability."

Meanwhile, the sector's other source of income—underwriting premiums—is coming under pressure from customers. "The second thing we face in this renewal cycle is the surprising power in the hands of clients with respect to pricing," says Mr Karl. "Prices came down a bit in the January renewals, particularly in reinsurance. But it's also been soft on the primary side."

Figure 1

Optimistic on the prospects for your organisation in the next 12 months



# A risky business

Insurance is inherently about managing risk, and for Mr Benmosche the key to surviving these challenges is flexibility. "We live in a rapidly changing world, so it's really about being able to adapt to those changes, and to mitigate risk appropriately," he says.

Added to these pressures is the substantial regulatory change that is being rolled out globally. In Europe, the EU's long-delayed Solvency II Directive is at the heart of the transformation of the industry, bringing uniform capital rules and risk management systems. This legislation is likely to require insurers to bolster their capital bases and/or hold more capital in the form of common equity.

"A lot of this is for the best," says Mr Karl. "But in the interim, you have the costs of adjustment and aligning your capital and risk-management techniques to the regulatory environment."

Driven partly by the increased costs of complying with new regulations, another worry for insurers is consolidation, particularly in a highly fragmented industry.

For Michael Morrissey, president and CEO of the International Insurance Society (IIS), an industry organisation, the main concern is that in pushing for global harmonisation of the rules governing the insurance sector, regulatory authorities may be making it too difficult for companies to comply. "There are cultural and economic differences in different markets around the world. The regulatory goal of one world is a laudable goal," says Mr Morrissey, "but it will be very expensive and time-consuming to execute."

Meanwhile, as new regulatory regimes such as Solvency II increase data reporting requirements for insurers, firms see transparency as an increasingly important part of their agenda, with the majority (85%) of the respondents saying that the demand for transparency has never been higher. The regulatory regime is ranked fourth among the drivers of transparency, with 27% of respondents citing this as a factor increasing the need to embrace corporate responsibility. Other factors are also driving increased transparency, however, with client expectations seen by most (34%) as the biggest driver of corporate responsibility, followed by workforce expectations and stakeholder engagement (both cited by 30% of insurers), and senior-level engagement and resource efficiency (both cited by 29% of respondents).



*adapt to  
change*

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# Industry consolidation

Consolidation is a key worry for insurers. In the survey, industry consolidation is highlighted as the second-most important risk their companies will face over the next year (Figure 2).

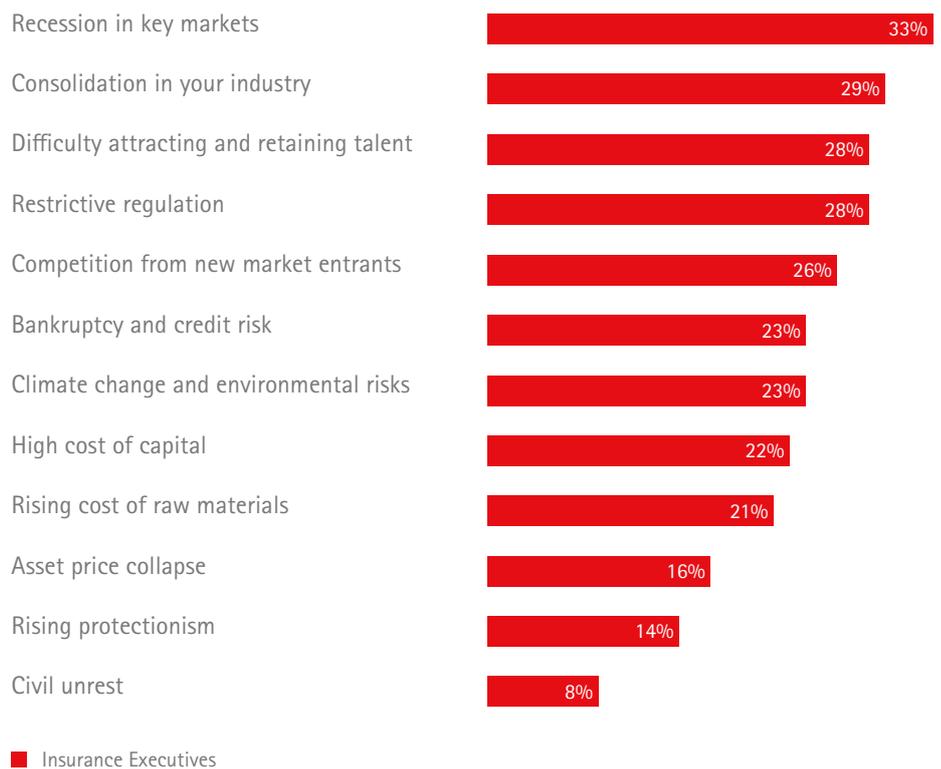
Some see pressure mounting for firms to embark on mergers or acquisitions as the need to invest in technology becomes greater. "The table stakes for having adequate technology are going way up," according to Mr Morrissey. "And that, in turn, is one of the factors likely to accelerate the industry consolidation. This is a poker game—you've got a few big companies sitting around the table with piles of chips and you have smaller players that have lived by their wits all this time. But this makes it very difficult for them."

The pressure to increase investment in technology is not the only factor likely to drive industry consolidation. The tightening of regulatory regimes around the world is another. Mr Morrissey predicts that the cost of complying with new regulations "will, among other things, accelerate the consolidation of the industry because smaller companies can't afford the escalating cost of compliance."

For some, however, the prospect of consolidation presents opportunities, particularly since the shrinking global presence of banks such as HSBC, ING and others means that these institutions are selling their insurance operations in Asia and Latin America.

Figure 2

Top risks in the next 12 months



For reinsurers, there are opportunities too. After a merger or acquisition, insurers that find themselves with too much of a particular type of risk may look to sell some of their portfolio to another company, often a reinsurer, explains Mr Karl. Property and casualty business can be sold in a "run-off" transaction, as can the life insurance side of the business. In addition, he says, a company might lack sufficient capital to expand a certain line of business. Reinsurers have taken on some of the risk, freeing up capacity for growth.

"With all these things going on, there's room for mergers, acquisitions and devolutions," says Mr Karl. "We're bullish on that potentially helping our business as well, as we help our customers by taking on some of their unwanted portfolios."

### New markets on the horizon

Adding to a sense of optimism is the industry's view that emerging markets hold opportunities for growth. Insurers seem to be more upbeat than other executives, with most seeing strong or stable growth in these markets. While 43% of all respondents see a slowdown in major emerging markets in the year ahead, only 33% of insurers believe this will be the case, with 67% predicting strong or stable growth for these markets—compared with 57% overall (Figure 3).

For Mr Benmosche, the opportunities vary. "Looking at emerging markets is a lot like looking at a weather map in which there are positive and negative situations," he says. He favours Latin America, owing to its economic growth and the expansion of its middle class. While China has good prospects, he sees its ageing population as a challenge. "And the Middle East has to be capable of reinventing itself without depending on oil. In short, everything is changing, and it is necessary to know which way the tide is going."

Insurers are less worried than most other sectors that developed-world monetary policy changes will negatively affect emerging markets, with 28% highlighting this as a problem (versus 34% overall), and 72% saying these changes will not have an impact on emerging markets (versus 66% overall).

This makes sense, since developing countries may become more lucrative markets for insurance. As populations grow older rapidly in economies with limited state health and pension systems, the lack of state coverage will force citizens to turn to private providers for medical insurance and savings products.

Among emerging markets, insurers in Asia have benefited from the fact that the region has experienced little recessionary impact. With most of its major economies continuing to grow, many insurers are attracted to this region.

In an industry that expands in places where income streams are growing and consumers and businesses have greater assets to protect, the growth of emerging markets (albeit at a slower rate than in recent years) can provide business opportunities: as consumers and businesses in these markets acquire more assets, they will seek protection for those assets. "You have more cars, more houses being built, more freeways, airports and construction activity, particularly in emerging markets, but also globally," explains Mr Karl. "This will boost demand for insurance."

Reflecting this, insurers are looking overseas for growth, especially in emerging markets other than the BRIC economies (Brazil, Russia, India and China). Among respondents in the insurance sector, 62% say their focus will be investments in overseas markets (Figure 4). And when it comes to overseas investments, more say they will be investing outside the BRIC countries (63%) than in the BRICs (37%) in the coming year.

In both developed and emerging markets, they are looking to entice new customers with new products and services. More insurance industry executives point to this strategy than those in other industries. Outside their home market, the largest proportion of insurance industry executives (61%) say that they plan to sell new products and services to new customers in emerging markets, far more than their colleagues in the banking sector (45%).

Figure 3

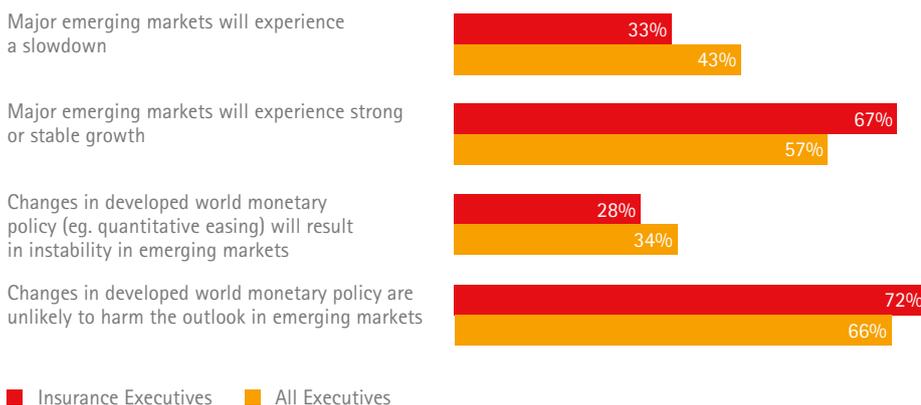


Figure 4



# Investment priorities

Driven by the demands of compliance requirements and increased overseas investments, hiring is on the rise in the insurance industry.

More executives in this sector (70%) say they are going to be increasing their workforce in the next year than their global peers (65%). They are also prioritising human capital, with 84% saying they will invest in recruitment, retention and training in the next year (versus 75% overall).

This represents a change for many insurance firms. "Traditionally, the industry has not paid enough attention to talent, but growth and profitability challenges have made the industry aware that it has to compete on talent," says Mr Morrissey. "The amount of time spent on recruitment, training and identifying high-potential people is now a multiple of what it used to be."

At the same time, however, the industry is trying to cut costs. Fully 72% of respondents in the insurance industry see this on the horizon in the next 12 months (versus 58% overall). Given that the industry plans to increase its headcount, reducing overall expenditure will require significant productivity gains.

At AIG, one way of streamlining the business is to move some jobs to lower-cost locations. "Now we have begun to eliminate the jobs that have been replaced as we move them," says Mr Benmosche. "There is a lot of that going on right now."



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recruit high performers

# Digital routes to efficiency

One possible route to increased efficiency is investment in digital technologies. In larger numbers than their global peers, insurers believe that enhanced digital infrastructure—such as fibre-optic networks, telecommunications infrastructure and higher broadband speeds—would do most to increase the competitiveness of the country in which they are based.

And for insurers, the primary purpose of digital technology investment is to enhance efficiency, which will help them in their cost-cutting efforts. Here, 68% of insurers say that technology's main role is to enhance operational efficiency (compared with 59% overall), with only 28% of insurers saying its function is to promote growth (Figure 5).

For many firms, technology is a way of improving what they do. "Part of what we're going to see at AIG is a lot more refinement in how we use data, which is a competitive advantage for us because we have more information than most about many risks," says Mr Benmosche.

Mr Karl sees big opportunities for the industry to embark on new ways of doing business. He points to the benefits of increased computing power, greater access to data and improved statistical analysis, as well as mobile technology. "We're getting to the point where we can start thinking about pricing and selling entirely on the Internet," he says.

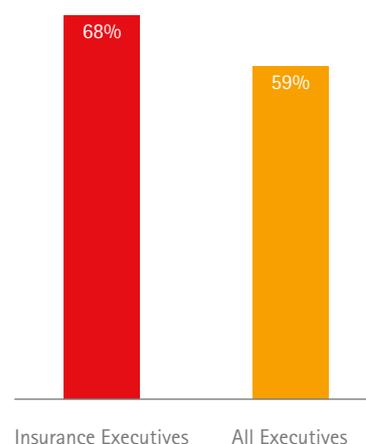
On this point, survey respondents agree. E-commerce emerges as the most important technology for insurers, with 57% highlighting this, a similar proportion to their colleagues in the banking industry (55%).

Meanwhile, 42% of insurance industry executives highlight mobile technology as an important tool for their businesses. "The mobile phone has become a key instrument for banking and insurance products, particularly in emerging markets," according to Mr Karl, "because strong brick-and-mortar structures aren't in place in many countries."

Mr Morrissey believes that the non-life side of the industry, in particular, can tap into the promise of digital technology. "Things like telematics and the use of big data present opportunities, not only for accounting systems but also to do predictive modelling, underwriting and claims handling," he says. "All of a sudden, technology is a much broader tool than it used to be."

Figure 5

Our approach to digital business investments is primarily focused on process efficiencies and cost reduction



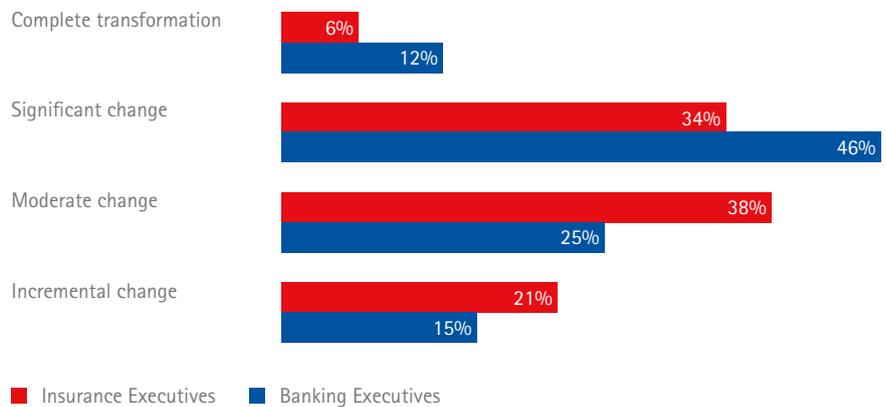
But while in the survey more than half of their global peers see digital technologies as having a transformational effect on business, insurers have a lower expectation that this will be the case, with only 40% of them agreeing. This contrasts with the banking sector, which has been less sheltered from the threat of new market entrants and has therefore had to move faster in embracing technology. Among respondents from the banking sector, 58% see digital technologies as transforming the business, while 52% see mobile technology as important—10 percentage points more than insurers (Figure 6).

Technology is one path seen by insurers as a means of winning customer loyalty. Nearly two-thirds (63%) of insurance executives cite the customer experience as an important use for digital technologies. More tailored engagement across multiple platforms is a key part of this opportunity. As investments rather than underwriting tend to drive insurers' revenues, some firms have not focused enough on their customer relationships, and this is a key area for growth.

However, the insurance industry faces several barriers to the greater adoption of digital technologies. For smaller companies, the main issue is cost. "These opportunities for technology end up being very expensive, and what that means is that the big players, if they're fast movers, can extend their cost, scale and profitability advantages over smaller companies," says Mr Morrissey. "The smaller companies, in large part, are in denial, and they are hoping that these trends take a long time to develop because they're so expensive to capitalise on."

Figure 6

To what extent will digital technologies change your industry over the next 12 months?



For insurers, the pressure to move forward is mounting. The industry is entering a new era in which increased regulation is combined with growing demand among customers both for more competitive premium pricing and the ability to conduct their financial and insurance transactions online. Digital technology could help insurers manage both these challenges. But while their peers in the banking industry have moved faster on technology, partly as a result of pressure from customers, in the insurance sector change has come more slowly. With new market entrants ready to take a slice of insurers' market share—and one-quarter of insurance industry respondents cite this as a risk—the stakes are high. Therefore, the question for an industry that is by its nature cautious is: how quickly can it rise to meet these challenges?

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