

Business Pulse

Exploring dual perspectives on the top 10 risks and opportunities in 2013 and beyond

Insurance report

The EY logo is positioned in the bottom left corner of the page. It consists of the letters 'EY' in a bold, white, sans-serif font. The background of the entire page is a photograph of a sunset or sunrise over a forested hillside, with a large yellow triangle pointing towards the center and a series of white vertical lines on the left side.

Building a better
working world

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Introduction

Forecasting the future is risky, but businesses that fail to look forward will almost certainly be left behind in an increasingly competitive and globalized world. By exploring the top 10 risks and opportunities in the insurance sector in 2013 and looking ahead to 2015, this report takes the pulse of current thinking and expectations from industry executives and EY specialists. The results can be used as a benchmark for your business and can feed into strategic decision-making.

The top 10 risks and opportunities are based on a survey of executives at over 65 insurance companies across the globe, representing both rapid-growth and developed markets. The rankings were discussed with relevant business executives and EY experts, to gather the insights and perspectives on which this report is based.

Our research reveals that macroeconomic trends and a slower rate of growth are viewed as the leading risks for insurance companies. Closely linked to the current economic environment is the Eurozone debt crisis, which is high on our list of risks and remains a potential trigger for further uncertainty.

There are two notable new additions to the top 10 risks this year. One is the twin challenge of cyber-risk and data security, which has moved beyond the aim of simply keeping data secure to encompass new issues such as systems security and data collection. The other is acquisition and retention of talent. This is closely linked to the challenges of greater regulation, the increasing use of sophisticated modeling to calculate risk and capital requirements, and a new emphasis on customer reach.

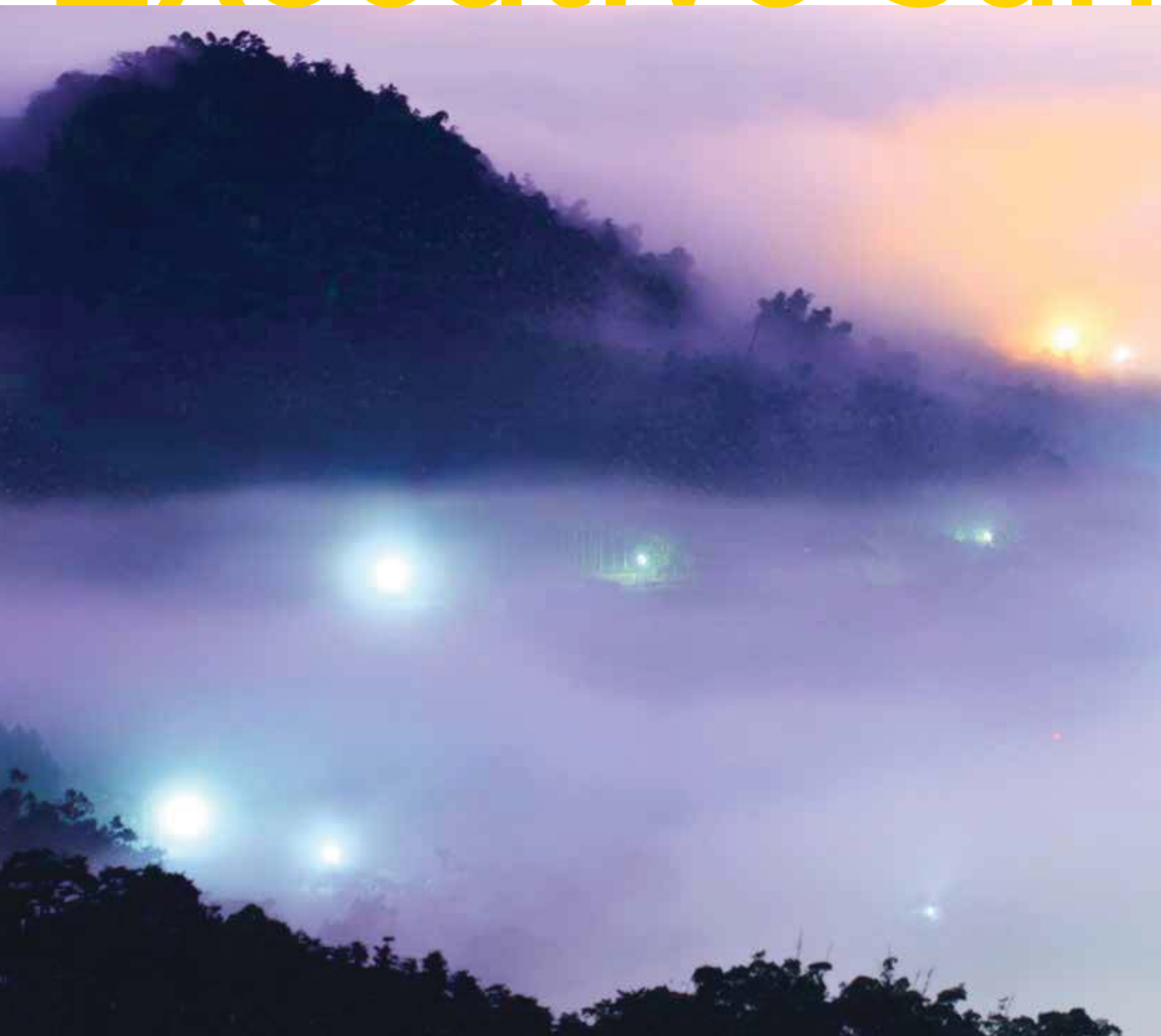
Customer focus dominates our list of opportunities. These range from a greater ability to understand and anticipate the needs of consumers, to demographic changes that will encourage improved distribution and product development.

This year, we have organized our findings around the four key drivers of growth identified by EY's *Growing Beyond* program: cost competitiveness, stakeholder confidence, operational agility and customer reach. According to relevance, our risks and opportunities have been divided between these categories, and our discussions take this grouping into account.

The executive summary gives more detail on these four themes and provides an overview and a dual perspective. Ultimately, though, the purpose of this report is to provoke discussion and debate about how your company is meeting the challenges and opportunities of today – and tomorrow.

We would like to extend our thanks to all our survey participants for taking the time to share their thoughts and experiences with us. We look forward to discussing further the implications of these findings with our clients and prospects, regulators and governments, as well as analysts and universities.

Executive sum



Summary

This year's list of top risks and opportunities makes it clear that the insurance sector needs to adjust to a new environment of lower returns on assets and stricter regulation on everything from capital allocation to commission rates and customer care. Our latest survey reveals that companies have few illusions about the challenges ahead. In their search for growth opportunities, insurers are confronted with a shortage of skills, threats from cyber-risk and data security, as well as concerns about operational and reputational risk.

In our survey, senior executives talked about the opportunities already within reach. Some involve using new requirements from regulators to create competitive advantage by embracing enterprise risk management (ERM) or re-optimizing capital structures. Others involve employing new technologies to turn huge amounts of data into a comprehensive understanding of customer needs that can underpin the launch of new products.

One key finding of our survey is that companies are now renewing customer focus to meet demand one individual at a time. As they tout the advantages of insurance to a new and younger audience, insurers are redesigning products for an aging population to interact better with customers approaching retirement. With greater online interaction and higher consumer expectations, it is not surprising that improved distribution and product development ranks as the top opportunity identified in our survey.

For many organizations, the current climate presents stark choices. And reviewing deep-seated internal processes and values often cuts to the heart of corporate culture. Yet today's top-performing companies are building flexibility into all aspects of their business to achieve the cost competitiveness they need. Those that succeed will optimize capital and asset liability strategies, while managing costs and generating revenue.

Forthcoming regulation could also provide insurers with long-term opportunities. Moving toward improved enterprise-wide risk governance may lead to more effective risk management. Furthermore, the determination of regulators to promote fair outcomes for customers should help to bolster stakeholder confidence in the industry.

Finally, we discuss the geopolitical risks that may emerge over the next three years and may impact the top 10 risks and opportunities in this report.



Cost competitiveness

Working with less

One of the main consequences of the 2008 fiscal crisis has been to increase the difficulty of obtaining capital. For many organizations, such difficult times present stark choices and prompt reviews of deep-seated internal processes and values that often cut to the heart of corporate culture. Yet today's top-performing companies are building flexibility into all aspects of their business to achieve the cost competitiveness that they need. This is particularly true in the insurance sector: firms that will succeed are those that have clear strategies – particularly with regard to crucial issues regarding capital-structure optimization and asset liability strategies – that encompass cost cutting and revenue generation.

Stakeholder confidence

The right response to risk

Forthcoming regulation will establish further capital requirements for firms. Solvency II in Europe, which is intended to standardize the continent's insurance market by aligning regulations across national boundaries, is a particular concern in this area. Despite some implementation delays in Europe, the substance of Solvency II has also been adopted, in whole or in part, by regulators across the world. In the absence of a truly authoritative supranational authority, Solvency II provides a framework to guide other local and regional regulators.

The mitigation of risk in this area could provide organizations with long-term opportunities. Moves toward more effective enterprise-wide risk governance may lead to more effective risk management. Organizations that take a holistic overview of their risk portfolios, with input from several business units, could gain a more accurate overall appreciation of risk. At the same time, as key stakeholders, the determination of regulators to promote fair outcomes for customers should help to bolster confidence in the insurance sector. This is particularly crucial as the sector embarks on the challenge of developing new products that will often be aimed at segments of the market unfamiliar with purchasing insurance.

Customer reach

Meeting new demand one individual at a time

Our survey has shown that macroeconomic conditions stemming from the fiscal crisis, compounded more recently by the crisis in the Eurozone, have taken a toll on the ability of insurers to reach customers. They are also affecting how customers view their need for insurance. But at the same time, the prospects are bright for those companies that can not only revamp their distribution channels to take advantage of new purchasing habits among consumers, but can also find new ways of encouraging customers to buy, by presenting insurance as an essential and valued part of everyday life. Today, social media tools are likely to form a crucial part of most companies' strategy in this area, albeit with associated reputational risks, as companies grapple with new and unfamiliar ways of doing business.

In rapid-growth markets, companies that can “relaunch the brand” and reach customers for whom insurance is a new prospect, will be well placed as household incomes grow. And new markets for insurance are not limited to rapid-growth markets: the Hispanic market for insurance services in the US is a strong example of a non-traditional, rising market within a mature economy. In these economies, opportunities are also developing in areas of life where insurance can help, especially for health and pensions. This will become more acute as the state's ability to provide universal coverage in these areas continues to face fiscal pressure.

Operational agility

Keeping one step ahead

Corporate agility can best be described as the speed and ability of businesses to identify internal and external events that could have an impact on them and to then react appropriately. In the current environment, being the first to react to change can often prove a major source of competitive advantage. In addition, it is crucial because a company that has a realistic understanding of its agility is much better placed to assess its appetite for variability and risk. The more agile a firm is, the more comfortable its board can be with a strategy that is likely to be affected by changing conditions.



When the economic outlook is relatively predictable, heavy investment in a particular product line can lead to handsome economies of scale. But periods of economic uncertainty, particularly if there's also limited access to credit, can turn this model – which was successful for most of the 20th century – on its head. Add in the speed of technological change, a customer base with an experience-driven approach to purchasing, and a proliferation of delivery challenges, and the virtues of concentrating the core of corporate value in a standardized and unchanging production process quickly fade.

With external factors constantly changing the business environment, a deep understanding of constantly evolving customer requirements and expectations is needed. Firms that can accurately and objectively assess the prospects for serving a new demographic group, assess the risks involved in developing a new product line, and cut the lead time involved in bringing it to market will gain a competitive advantage. When the criteria for success hinge on the ability to adapt with speed, a prime characteristic found in most market leaders is agility.

Some of the other key findings emerging from our research are as follows:

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

Business model innovation is number 10 risk in 2015

EY risk and opportunity radar

The risk and opportunity radar allows us to present a snapshot of the top 10 risks and opportunities for insurance companies.

At the center of the radar are the risks and opportunities that our survey respondents cited as having the most significant impact on insurance organizations worldwide. Arrows indicate the extent to which the ranking is expected to increase, decrease or remain the same between 2013 and 2015.

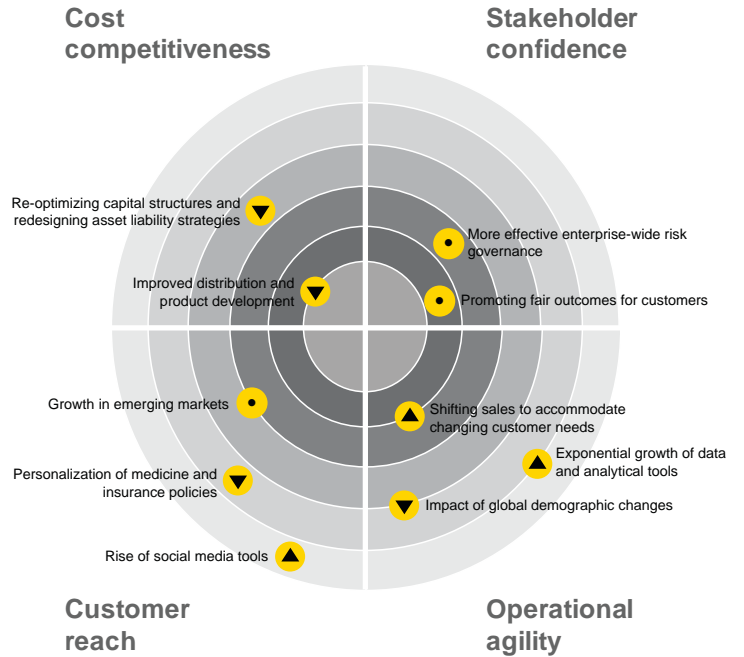
The radar is divided into four sections, corresponding to EY's *Growing Beyond* model:

- ▶ **Cost competitiveness:** sustaining organizations' economic viability
- ▶ **Stakeholder confidence:** encouraging firms to build stronger relationships with their stakeholders
- ▶ **Operational agility:** improving organizations' ability to deliver effectively in a quickly changing market
- ▶ **Customer reach:** maximizing the potential market opportunity for products and services

Top 10 risks



Top 10 opportunities



2013 ranking and expected 2015 ranking

▲ Up in 2015

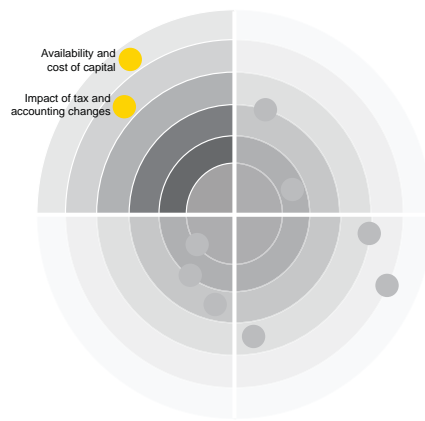
● Same in 2015

▼ Less in 2015

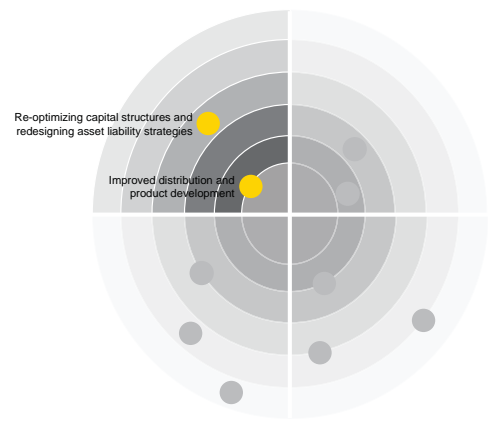
Cost competitiveness

Working with less





Risks



Opportunities



The current macroeconomic environment presents the insurance industry with a broad range of cost pressures; the global financial crisis and Eurozone crisis are still having a substantial impact. Insurance companies also need to account for widespread regulatory changes in both Europe and the US. At the same time, aging populations have the potential to redraw insurers' capital expense patterns in the near future. And compounding this, insurers need to be more competitive about cost, as the internet has given consumers unprecedented power over their insurance choices.

In the short term, the global financial situation is not improving – and it is difficult to account for the cost implications of this uncertainty. Success will be reserved for companies that can change their business models to cope with a low-growth environment. As insurers make extensive changes and prepare for new regulations, many will focus on internal processes, but they must not lose sight of the customer.

A changing environment brings significant cost risk, but also great opportunities. As the internet and other technological advances have given consumers power, the sheer volume of data available to businesses is as yet an under-tapped resource.

Impact of tax and accounting changes: the slow march of progress

Table 1 Ranking from 2013 to 2015		
Risk	2013 ranking	2015 expected ranking
Impact of tax and accounting changes	8	9

How is your business approaching regulatory change?

The financial crisis and its impact on the Eurozone economies prompted regulators to initiate a variety of systemic overhauls across the insurance industry. Tax and accounting changes could have a substantial impact on companies' cost competitiveness – and are a good example of “known” risks that insurers have dealt with in the past. However, uncertainty persists about the outcome of efforts to coordinate evolving regulations and standards across major jurisdictions.

In the US, regulators are continuing the process of rule-making in response to the Dodd-Frank Act of 2010, amid uncertainty about how the implications of some of its longer-term provisions will play out. The announcement from the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in 2012, that they will not be aligning standards in the near future, means that many insurers will continue to deal with multiple accounting and reporting systems. Regulation in areas such as financial instruments will undoubtedly progress in the next two to three years.

The overall rating of the impact of tax and accounting changes reflects widespread belief across the industry that these changes present unforeseen risks. Tax and accounting changes are closely tied to regulation risk. While their future makeup is potentially uncertain, any risks in the short or medium term are well documented. Some executives we spoke to noted that, as a result of the heightened attention to internal processes mandated by tax and accounting changes, they had lost sight of their customer focus.

Availability and cost of capital: a continuing concern

Table 2 Ranking from 2013 to 2015		
Risk	2013 ranking	2015 expected ranking
Availability and cost of capital	10	6

How will you continue to attract investors?

Adapting internal processes is an inevitable aspect of coping with changes to tax and accounting regulations and may distract from other activities. To remain cost competitive, insurers need to adapt business models to a slower-growth environment. In our survey, both high- and low-performing companies noted that the cost of bank financing is increasing. Ranked as risk number 10 on our list, it would be easy to assume that concerns about the availability of capital are not a high priority. However, executives worldwide believe this risk is likely to rise significantly between now and 2015, potentially moving into the top six risks.

The industry's enforced shift away from asset-based income streams has had a considerable impact on attracting investors. With the move to bolster income generated by fees for services, the returns on any investment now more closely reflect fluctuations within the wider economy.

As Solvency II, the new European Union (EU) directive, continues to progress, it is worth considering the availability and cost of capital in the context of regulation and Eurozone risk. It is not clear what capital requirements will be in uncertain financial conditions, which makes it difficult to determine how much capital a company will need to access. As EY's Pierre Planchon explains: “An important aspect of the renewed emphasis on capital requirements is the amount of time and effort that companies are spending to convince regulators and communicate to investors that they have sufficient capital both now and in the future, despite the macroeconomic situation.”

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Pierre Planchon, EY, Europe

Improved distribution and product development: changing behavior and building confidence

Table 3
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Improved distribution and product development	1	3

Has your business adjusted to new technology?

The top opportunity identified by our survey involves the creative use of products and distribution techniques to change customer behavior, reduce the need for direct personal interaction, and maintain levels of customer appreciation. The industry has a long tradition of making the point of contact between the company and customer a face-to-face meeting with a representative or broker.

The widespread use of the internet in today’s economy, and in particular the development of price comparison websites, is beginning to have an impact on insurance. Many consumers conduct online research prior to making major purchases. With website design and navigation at such an intuitive level, insurance products can be compared for price and coverage with relative ease.

While some customers ask which policy most closely matches their needs or represents the best financial value, others look for the quality of service the insurer provides. The ability to access the online experiences of other customers is an integral part of the pre-purchase research process. The speed and friendliness with which claims are handled, and the way customers are treated, can have a significant influence on the choice of insurer. This is especially true after an extreme event, such a hurricane, which may leave policyholders from different companies facing similar situations. Experiences of this kind speak to the issue of trust, which is central to insurance purchases.

Online interaction also offers the opportunity to learn more about existing and potential customers, from tracking the way in which online resources are used, to examining how questions and comments are posted. With more customer-related data now available from a range of sources, companies with the ability to collate and interpret that data have an advantage in perceiving and targeting demand for new products. More importantly, they have the chance to control the customer experience and manage the costs of attracting and retaining that customer.

While this shift in distribution channels has occurred because of new technology and changing customer attitudes, traditional channels such as banks and commission-based networks have contributed as well. According to Pierre Planchon: “In Europe, between 60% and 70% of life premiums in places like Belgium, Spain and Italy have been collected through banking networks. However, since banks have had an issue with liquidity, they have reconstituted their retail networks to emphasize savings accounts, which attract deposits and increase their liquidity. The need for liquidity has not overtaken the profit that can be earned from the commission of selling these life insurance products.”

New technology has also provided game-changing innovations in product development. Telematics, the use of sensors built into cars to capture detailed information about individual drivers, offer a vision of how technology, in combination with changing customer attitudes, can lead to new products and revenue streams. Proponents of telematics present a win-win situation for both driver and insurer. The driver’s premium reflects the risks of using the car, and the opportunity to lower premiums by making adjustments. For the insurer meanwhile, there is an opportunity in product development where an investment in determining corporate strategic fit may outweigh first-mover advantage.

Re-optimizing capital structures and redesigning asset liability strategies

Table 4
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Re-optimizing capital structures and redesigning asset liability strategies	6	7

Properly managing a combination of prudential regulatory, risk-based capital regimes within a highly challenging macro environment will require collaboration across functions. No one individual can fully understand investment opportunities, asset risk and risk-reward balance on yields. Companies need the CRO, CFO and CIO to be interacting at all times.

Have you accounted for population changes?

For insurers struggling with the cost of capital in the current macro environment, improving both structure and strategy is essential. The benefits of optimizing capital structures, and reducing the overall cost of capital, include greater flexibility and added stakeholder value.

The aging of the baby-boomer generation has serious capital expense implications. Insurance companies have enjoyed a long period during which the baby boomers, the first generation to purchase a range of insurance on a large scale, prepared for retirement by accumulating savings. After years of generating revenue, the industry is entering a period dominated by the need to make payouts to the boomers – and at a time of slow growth and low investment yield. Moreover, younger generations are contributing less for their future retirement, as different product lines are delayed or deferred.

As a result, the need to find new investment vehicles to produce higher returns at an appreciably acceptable level of risk is becoming acute. Some companies are looking to retain relationships with customers who are entering retirement, and encouraging them to move money from retirement-related accounts to brokerage accounts. By offering assets with a higher return, but still within risk-appetite boundaries, companies will have a competitive advantage.





There is an opportunity in product development where an investment in determining corporate strategic fit may outweigh first-mover advantage.

What it all means for businesses

A challenging macro environment has persisted for several years, with the initial credit crunch and recession exacerbated by a sovereign debt crisis in Europe. After making cost-cutting measures, insurers must look to underwriting margins, capital structures and asset liability strategies to remain profitable. To remain cost competitive, they must improve distribution techniques and develop products to change customer

behavior. Moreover, internal processes need to be adapted to address tax and accounting changes and the uncertainty of evolving regulatory standards. These crucial issues have placed a burden on capital availability, requiring companies to show investors and regulators that they have access to sufficient levels of capital.



Stakeholder confidence

The right response to risk





Risks



Opportunities



Maintaining good relationships with stakeholders is all about building confidence. And the current global economic environment provides ample opportunity for trust in corporations to be eroded. To a large extent, the regulatory change reshaping the insurance landscape has emerged from a lack of stakeholder confidence in financial services.

The most extensive regulatory changes will be international in scope, and we see a broad set of new regulations emerging as a major source of risk. Amid the confusion of regulatory change, it is crucial for internal stakeholders to have confidence in corporate governance. With shareholder activism on the rise, there is a significant risk that boards and non-executive directors could be found wanting in this area. However, this also presents an opportunity for boards to take a “holistic” approach to risk management.

A goal of regulatory change is to improve “fairness” and encourage ethical practice, rather than bottom-line compliance. Increasing pressure on costs affords insurers an opportunity to maintain a good reputation, compete on more than simply cost, and ultimately put customers first.

Regulation: expanding scope and coordination among regulatory agencies

Table 5
Ranking from 2013 to 2015

Risk	2013 ranking	2015 expected ranking
Regulation	2	1

Are you prepared for new regulations – wherever you are in the world?

Insurance companies have been preparing for Solvency II for several years. The directive, which was intended to standardize the European insurance market by aligning regulations across national boundaries of EU Member States, has been far reaching. It will provide greater coordination of insurance regulation on a global scale, but also presents a potentially difficult transitional period as companies implement the substantial changes necessary to meet new regulatory requirements.

At present, both the US and Japan are continuing with a “liability only” solvency regime, rather than the “total balance sheet” approach that Solvency II ushers in. Under the latter regime, all risks and their interactions are considered in order to create a better assessment of the real-time risks of particular insurers. As a result, there are concerns among insurers domiciled in Europe that the higher capital requirements stemming from risk assessment under Solvency II will be a competitive disadvantage – hence the high ranking of regulatory change in our top 10.

An additional concern is that the value-at-risk approach of Solvency II may deter insurers from holding large equity portfolios. This would limit insurance investment opportunities, while also negatively impacting equity markets in the UK, France, Germany and other countries, where insurers are large holders of equities.

Along with the competitive risks associated with Solvency II capital requirements is the more basic uncertainty about when it will actually come into play. Implementation has been postponed to give insurers time for more extensive preparations and the current date of 2014 may be pushed back another two or three years.

US initiatives and consumer protection

The alignment of supervision in Europe that underpins much of Solvency II has not yet bridged the Atlantic. In the US, insurers continue to deal with 50 state-level regulators and 50 attorneys general, in addition to the renewed interest of the Federal Government. They have been caught up in capital requirements generated by the recent banking crisis, despite the fundamental difference in the needs of the two industries to have capital on hand.

Regulatory compliance imposes a significant cost burden on insurance companies in North America, albeit not as onerous as the preparations required in Europe for Solvency II. In particular, those insurers with cross-ownership ties to banks are experiencing the effects of the additional regulatory burden. The role of the new Office of Federal Insurance in the US, established by the Dodd-Frank Act, with the responsibility for identifying regulatory gaps that could contribute to systemic failure within the sector, is neither fully determined nor understood. It represents another layer of scrutiny that is as yet unclear.

While Solvency II has been a preoccupation for insurers in Europe, this risk also encompasses wider aspects of regulation in areas such as consumer protection. Two new regulatory authorities now operate in this field: the Financial Conduct Authority, which takes up regulation of the marketing of financial products in the UK from April 2013, and the Consumer Financial Protection Bureau, which has been operating in the US since 2011. In the wake of the 2008 subprime mortgage crisis, both represent a new government emphasis on the regulation of how financial products are marketed and sold. Additionally, both also have a purview that stretches throughout the lifetime of the product.

Other regulatory concerns

In the Asia Pacific region, concerns about regulation center less on consolidation than on the fragmented nature of regional markets and different regulatory regimes. As Paul Clark, EY’s Asia Pacific insurance leader, points out: “Asia has a mixture of mature, developing and emerging markets, and whilst we anticipate a significant amount of regulatory change across the region, certainly relative to the West, this will differ by country”

In South Africa, several significant regulatory measures are being introduced in quick succession, including a retirement reform and measures similar to Solvency II. As Andre Zeeman, Chief Actuary at Sanlam, explains: “In the UK, you would spend 10

“Asia has a mixture of mature, developing and emerging markets, and the amount of regulatory change across the region will differ by country.”

Paul Clark, EY, Asia Pacific

years on this, and we are doing it all in 2 or 3 years.” However, such a concentrated period of regulation comes with a price, he says, in terms of management attention and company resources. Moreover, when a company is also active in another jurisdiction implementing new regulations, the strain on management is intensified.

The executives we spoke with were divided on the status of regulation in Japan. Those focusing primarily on domestic regulation, including Kimihisa Harada of Dai-ichi Life, were of the opinion that this risk had less of an impact than our survey indicates. “I don’t regard a change in regulation in the future itself as a risk because we have already implemented an internal management on a basis of economic value, though if a large change in regulation would occur in the future, this would be more of a risk.” Those with closer links to other markets, however, might see it as considerably more important. “Since our company follows the financial sector in Europe quite closely, any regulatory uncertainty there will have an impact on us,” said Masahiko Tamamura of Tokio Marine.

The fragmentation of regulation on a global scale is more evident than the coordination underlying Solvency II. One notable element is the extent to which national regulators are establishing market rules requiring multinational insurers to protect their local operations. On a wider level, there are no global standards for crucial areas, such as capital requirements. This means that, not only is regulatory risk related to the increase in regulation at the national level, it is also linked to the lack of standardization at the supranational level. The fractured landscape that results from this is another reason why regulatory risk is a cause of such concern.

Corporate governance failures: bolstering confidence in the system

Table 6
Ranking from 2013 to 2015

Risk	2013 ranking	2015 expected ranking
Corporate governance failures	5	7

How will you maintain trust?

While reputational risk addresses the “view from the outside” – the external perception of a company – oversight of internal corporate governance is also necessary. This ensures management processes align with the company’s publicly-stated philosophy and values.

This risk would likely find a place in the top risks facing many sectors. Yet, many of those we talked to, who have recently confronted new regulatory regimes, view the risk of corporate governance failures as less of a concern than they may have a few years ago.

Even so, the fallout from the financial crisis has led to a rise in shareholder activism and increased emphasis on executive compensation and the role of the board. The traditional view of the board is primarily as a source of outside advice to senior management in developing and implementing corporate strategy – a view that management has generally endorsed. However, this is being superseded by a vision of the board as an important check on the aspirations and expectations of senior management – intended to ensure that the shareholders’ interests are paramount.

This particular challenge for non-executive directors may be made easier for insurers by new regulations intended to maintain closer ties between the level of risk a company takes on and its capital reserves. This limits the risk of an insurance equivalent to the disastrous lending practices seen in the mortgage sector before the financial crisis. Therefore, in many regulatory practices, including Solvency II, the compliance officer is encouraged to become a proxy for the regulators, ensuring that the company follows the spirit, as well as the letter, of the regulations. Combined with greater transparency requirements, this can limit the chances of failure in corporate governance and oversight. This is particularly important for an industry that relies heavily on cultivating and retaining the trust of its customers.

EY’s Pierre Planchon says that there have been relatively few clear examples of corporate governance failure in the insurance sector; instead, this is very much a concern from the banking sector that has spilled over. However, the central issue of trust means that the consequence of any perceived or actual corporate governance failure can be grave.

Promoting fair outcomes for customers: prospering fair-mindedly

Table 7
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Promoting fair outcomes for customers	2	2

Are you still putting customers first?

Maintaining trust is an important part of providing products and services. Insurers must embrace the underlying principles behind fair outcomes, rather than settling for the lowest level of compliance that is compatible with regulatory requirements.

New regulations, such as Solvency II, include a public attempt to bolster consumer confidence in insurance companies. Maximizing this potential will require a concerted industry-wide effort to highlight the integrity and financial strength of the insurance community. When customers appreciate a fair outcome, the industry is more likely to attract investors.

One of the legacies of the financial crisis has been the temptation to value cost savings over customer satisfaction. An increasing number of policyholders tend to frequently change providers, as insurers place more effort into attracting rather than retaining customers. Moreover, customers tend to take a good claim-handling experience for granted, which does not encourage retention or brand loyalty. While it has been a challenge to maintain customer confidence and satisfaction in recent years, there are signs of progress. For example, a September 2012 report from JD Power indicated that US customer satisfaction with homeowner insurance had reached an all-time high.

The fact that treating the customer fairly ranks at number two on our list of opportunities suggests that insurers who can demonstrate commitment in this area have a competitive advantage. The arguments in favor of treating the customer fairly are both commercial and regulatory. In 2006, the UK's Financial Services Authority unveiled its Treating Customers Fairly (TCF) initiative, and its six main points have provided the framework for

a similar approach in other countries. The objective is to ensure that customers receive clear information before, during and after they purchase a policy. Regulators, however, are looking for more: they would like the TCF implementation to be embedded within organizations.

This opportunity is not without its challenges, because consumers, particularly those who buy online, emphasize price as the point of differentiation when making purchasing decisions. Companies that focus on treating customers fairly are ahead of the curve with both customers and regulators in instilling stakeholder confidence.


More effective enterprise-wide risk governance: integrating risk management

Table 8
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
More effective enterprise-wide risk governance	4	4

Does your company take a "holistic" approach to risk?

The board should play a key role in any organization's efforts to improve risk management by integrating the process at the highest levels. Regulators, customers and other stakeholders need assurance that a company has a clear understanding of risk and how to minimize it. With regulators around the world concerned that insurers should have enough capital on hand to cover their corporate exposure to risk, a demonstrable ability to handle risk within internal processes and frameworks has never been more important. This is most effective when companies can take a holistic view of the risk they face from the boardroom, where internal and external risk can be considered together. Risk scenarios can be a useful tool in helping to understand how uncertainties can develop into risks.



“In the UK, you would spend 10 years on this, and we did it all in 2 or 3 years.”

Andre Zeeman, Sanlam, South Africa

Risk and risk mitigation at the board level extends beyond responding to regulator enthusiasm for ERM. The complexities of insurance can be a challenge for non-executive directors brought in from outside the industry. Yet, they can play a vital role in risk governance by questioning assumptions that underpin the company’s current market strategies and product lines. Such questioning about realistic, flexible and long-term risk and strategy can align risk appetite with corporate agility for competitive advantage.

This ERM model may end the widespread practice of thinking of risk management in silos. Different types of risk – such as underwriting risk or operational risk – should not be approached individually, but as part of a single risk management program,

the scope of which is not limited to each business unit. It gathers perspectives on a particular risk decision – including those of the CRO, the CFO, and the head of compliance – allowing risk managers to collectively set parameters and define the terms under which the risk should be accepted.

The catalyst for understanding risk management lies at the corporate level. In comparison with banking, CROs and board risk committees are still relatively new to the insurance industry, and many have overlapping responsibilities. Their roles will evolve between now and 2015, driven by factors that include an internal realization that these supervisory positions add strategic value, and the likelihood that external pressures will lead to better appreciation of risk management. An additional driver is the regulator’s desire for the CRO to be fully entrenched in the C-suite, to develop a risk culture throughout the organization.

What it all means for businesses

The scale and inconsistency of regulation is a huge burden across financial services, requiring corporate governance and overall risk management. The mitigation of risk in this area could provide organizations with a long-term opportunity to develop a more holistic overview of the risk portfolio, and a greater appreciation of risk as a whole. At the same time,

the determination of regulators to promote fair outcomes should help bolster confidence in the industry. While the cost of compliance is high, the consequences of non-compliance are not limited to fines from regulators; the central element of trust among the customer base may be irreparably damaged.

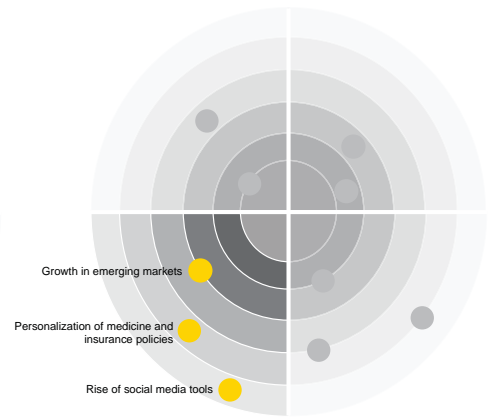


Customer reach

Meeting new demand one individual at a time



Risks



Opportunities



Our top risk for 2013, macroeconomic concerns, including slow growth and widespread market volatility, poses a real threat for insurance companies to reach and retain customers. Engaging with new customers is a crucial factor in staying afloat for insurers who can no longer rely on investment income.

Insurance companies are also vulnerable to reputational risk, because trust is a keystone of the business. In today's climate of increased public scrutiny, and general skepticism toward corporate practices, insurers face new levels of risk in this area – which will be compounded by new regulations such as Solvency II.

However, emerging economies offer vast new insurance markets and, as the middle classes in Russia, Brazil and China continue to grow, there will be new customers for many years to come. In addition, new communication channels through social media will reach new consumers – but this will require flexibility and strategic attention at the highest level.

Macroeconomic trends: an overarching challenge

Table 9 Ranking from 2013 to 2015		
Risk	2013 ranking	2015 expected ranking
Macroeconomic trends	1	2

How will you deal with ongoing slower growth?

Adjusting to a slower pace of growth in many markets affects both companies' ability to provide insurance at an acceptable rate of return and customers' need to purchase coverage. Macroeconomic trends pose an overarching challenge because, at present, they tend to distort efforts to identify, differentiate and retain potential new customer groups – hence we see this as the top risk for 2013.

For insurance companies, coming to terms with the current environment means boosting income generated by fees for services and a painful shift away from the growth models driven by asset management that they had depended on prior to 2008. The burden on monetary policy is particularly severe, because central banks across the world have signaled a need to reduce the “real” interest rate to further stimulate economic growth, despite a nominal interest rate at or near zero for the biggest Organization for Economic Cooperation and Development (OECD) economies.

Opportunities for returns on investments are likely to remain limited until 2015, which will pressure insurers to improve their underwriting margins. Respondents to our survey recommend expanding or buying into new markets, or developing products that either cover insurable risk or improve current offerings. The key is to maximize customer profitability, while acknowledging the difficulty this poses at a time of high unemployment in many countries.

Looking forward to 2015, we anticipate that another challenge will be that cost cutting has largely run its course over the past five years. The decline in revenue from investment assets has increased the importance of the profits contributed by underwriting, making investment in this area a logical response to the volatility in macroeconomic trends.

Eurozone debt crisis: a global concern

Table 10 Ranking from 2013 to 2015		
Risk	2013 ranking	2015 expected ranking
Eurozone debt crisis	3	4

Have you factored in the global consequences of the crisis?

The state of the current economic environment is closely linked to geopolitical events, the most significant of which is the Eurozone debt crisis – it is both a consequence of the recent financial downturn and a potential trigger for further uncertainty. The Eurozone's GDP is expected to contract by 0.1% in 2013, with implications that reach far beyond the borders of Europe.¹ Within Europe, as EY's *Eurozone forecast* indicates, the picture for investment is still relatively uncertain. Hard-pressed consumers have little cash to spare and spending – already hit by high unemployment – remains limited. For the foreseeable future, a low-growth scenario in the Eurozone is inevitable, and our survey indicates that the effect of the debt crisis on the global economy is a major risk. As Andre Zeeman, Chief Actuary of South Africa-based insurer Sanlam explains: “I think we will keep muddling along and face a scenario with slow growth. If the Eurozone cannot sort out its problems, it will lead to a downturn. We think that the crisis in Europe plays a major role in the gradual slowdown worldwide.”

If European governments choose to simply “muddle through” the crisis – managing to avoid catastrophe without producing any systemic improvements – this approach may pose a particular risk for the industry. There's likely to be an increasing casualty risk as companies suspend preventive and due diligence programs as part of a survival strategy to stay afloat. At the same time, individual consumers in Europe may come to see income protection and long-term care products as less reliable amid greater skepticism about financial services.

¹ Eurostat; Oxford Analytica forecast.

“We think that the crisis in Europe plays a major role in the gradual slowdown worldwide.”

Andre Zeeman, Sanlam, South Africa

Reputational risk: caught in the crossfire

Table 11
Ranking from 2013 to 2015

Risk	2013 ranking	2015 expected ranking
Reputational risk	4	8

How are you safeguarding your reputation?

The escalating level of regulation has challenged the effective management of reputational risk. With increased regulation comes a greater chance of failing to comply with aspects of each new requirement. This may lead not only to fines and other sanctions, but also to the perception of failing to adhere to a crucial ethical corporate standard. For an insurance company, the consequence can be severe: a loss of trust among its customers.

There is public wariness about all financial products, and the financial sector as a whole, in the wake of the revelations of the last few years. As a consequence, reputational risk's 4th position in our top 10 comes as little surprise. The active interest of many regulators in seeking changes and improvements from insurers, in areas ranging from customer satisfaction to capital adequacy, could also indicate that something needed “fixing” in the industry.

Many damaged reputations have been directly linked to specific instances of unpopular corporate practices or management failure. Furthermore, there is the reputational impact of potential job losses and their effect on corporate image in terms of reliability, solvency and empathy among customers. In addition, to established industry trends, there are new threats such as cybersecurity. As the internet has grown, so has the potential number of online threats, rendering traditional security models obsolete.

Companies believe that, because insurers have traditionally made little headway in cross-selling products to their customers, there is less to lose on a per customer basis if a firm suffers reputational damage. The high turnover rate in much of the industry cuts both ways: if customers have relatively little loyalty to their insurers and increasingly make price comparison purchases, they should be largely unaffected by bad publicity about a particular company or the industry in general.

Growth in emerging markets: adding security to prosperity

Table 12
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Growth in emerging markets	5	5

Have you gained a foothold in the developing world?

As customer needs change, so does the pool of potential customers in emerging markets. EY's *Customer reach: Targeting and satisfying customer needs* pinpointed participation in the growth of emerging-market economies as a key strategy for high performance. Such growth should ideally be based on an in-depth market assessment and a clear understanding of the local customer base.

As with many other sectors, insurance has been hoping to grow in emerging markets in order to supplement success or mitigate difficulty in developed markets. A brief glance at global demographics would seem to make this a sensible proposition. As we note in our global *Business Pulse* report, the number of emerging-market households earning above US\$30,000 will more than double to 149 million by 2020, overtaking both the US (120 million) and the Eurozone (116 million).² As part of this, the size and disposable income of the global middle class continues to increase as economic growth generates wealth in developing economies. Pensions and life insurance are benefiting from this trend – by 2050, over 30% of Chinese and 20% of Indians will be over the age of 60.

Given that much of the growth in the middle class is in the Asia Pacific region, a note of caution is warranted. Increasing levels of property insurance are being taken out in a region with a history of huge natural disasters. In an exceptional year for Asia, the region accounted for 80% of global insured losses from natural catastrophes in 2011. This suggests that there is a considerable risk profile for those insuring in the region. Furthermore, as

² Oxford Analytica research.

EY's Paul Clark points out: "Insurers need to think carefully about losses from natural catastrophes in the region, not simply in terms of scale, but also in terms of their tendency to cross national and provincial borders. As a consequence, different regulators will govern the responsibilities of insurance, increasing complexity and leading to the possibility of further compliance costs."

Brazil is another country with encouraging growth prospects. Although the Brazilian economy only grew by 1% in 2012, insurance rose at a double-digit rate. This growth has been powered by the country's overall economic strength, its expanding middle class, and an increasing awareness of the importance of insurance coverage and retirement planning. The Brazilian Confederation, which groups together the country's major insurance, health insurance, private pension and saving bonds federations, anticipates that total insurance, pension and saving bonds revenues will increase by a combined 55.8% in the period between 2012 and 2015. The surety business will be one of the fastest growing, as oil exploration expands and the country pushes infrastructure projects linked to the World Cup in 2014 and the Olympics in 2016.

Unsurprisingly, this boom has attracted local interest, with the largest Brazilian-owned investment bank moving into the insurance sector at the end of 2012, suggesting that, at some point in the future, the Government may be tempted to take measures that favor domestic companies. There are opportunities for international players to enter these markets, often through partnerships with local insurers. These players can offer experience and new technology, as well as lower financing costs in return for market access.

Personalization of medicine and insurance policies: no one-size-fits-all

Table 13
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Personalization of medicine and insurance policies	8	10

Are you prepared for a paradigm shift in health insurance?

In a world where every consumer expects customization, analytical tools enable a new layer of personalization that was previously impossible. "Customer-centricity" is a particularly big opportunity, according to Christopher Wei, CEO of Great Eastern Life: "Central to our customer-centric culture is our fundamental commitment to obtain better customer insights and generate new ideas on how the role of insurance, as well as the delivery of advice, can be enhanced."

"Our renewed purpose as a Life company – is to help our customers live healthier, longer and better lives – translating into a passionate commitment to deliver a unique customer experience anchored on the first integrated health and wellness program offered by an insurance company in the region."

The completion of the Human Genome Project sparked a new discussion about the future of health care and its impact on the insurance industry. One of the main points to emerge was the inherent potential in personalized medicine and the shift from a one-size-fits-all mentality. The ability to use personalized medical information and therapies to design insurance is a new frontier, and while it presents many risks, it is nevertheless a major opportunity.

Ethical questions, along with acceptance by professionals and the general public, may lead to substantial challenges. For instance, privacy issues raised by genetic medicine pose hurdles, and patterns of medical innovation are increasingly being shaped by



“Insurance needs a ‘pull’ style of marketing, since the products need to resonate profoundly with customers. Social media seems to be a ‘chat’ style of communications; it is useful for simple communication, but it is difficult to apply to profound communication concerning risk management.”

Shigeyuki Goto, MS&AD, Japan

ethics-based, rather than science-based, regulation. Inevitably, consent issues surrounding personal health data will be a problem – one expert noted that once the data is generated, such personal health information will eventually become available to the wrong people and abuses will occur. While personalized medicine is a sizeable opportunity, there is a considerable risk that associated technologies and data could be misused, leading to potential regulatory backlash.

Rise of social media tools for distribution or collaboration: new channels emerge

Table 14
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Rise of social media tools for distribution or collaboration	10	9

Can you reach your customers in 140 characters or less?

Identifying and understanding personalized customer needs is not the only factor in determining customer reach. Communicating this message to potential customers is also crucial, and it is in this area that the emergence of new communication channels will be most important.

The viewpoint of many of our interviewees was summed up by Shigeyuki Goto of MS&AD Holdings. He points out: “Social media has the potential to be a greater opportunity for the industry, but there are restraining factors. Insurance needs a ‘pull’ style of marketing, since the products need to resonate profoundly with customers. Social media seems to be a ‘chat’ style of communications; it is useful for simple communication, but it is difficult to apply to profound communication concerning risk management.”

Despite some concerns as to the applicability of social media in the context of insurance, Andre Zeeman from Sanlam notes: “It is definitely an area we are experimenting with. I believe it will become a part of the business.” It may hold risks as well as opportunities for established companies. With internet-based delivery, geographical boundaries are eroded and the advantage of being a local insurance provider all but disappears.

In spite of the customer-facing aspects of social media, it is worth remembering that a culture of awareness and encouragement of social media within the corporate structure can yield dividends. Many younger employees will hope, and increasingly expect, to share ideas and insights via blogs, forums and other social media tools within a corporate intranet. The use of social media to improve both the speed and scope of internal communication contributes to the operational flexibility that is a key aspect of competitive advantage.



What it all means for businesses

Given current macroeconomic trends, most of the key opportunities for the insurance industry lie in its ability to reach new customers and influence how they view their need for insurance. Demographic changes in both rapid-growth and mature markets allow middle-class consumers to start thinking about insurance. Meanwhile, advances in product

development and distribution have been enabled through new metrics and marketing channels, allowing the industry to serve more people with greater efficiency. Social media tools continue to gain importance in encouraging customers to buy insurance and to understand its value in everyday life better, particularly in areas such as health, retirement and pensions.





“We’ve launched a robust health and wellness capability that is primarily digitally distributed – all linked to help our customers live healthier, longer and better lives. Insurance companies are not doing enough on customer-centricity.”

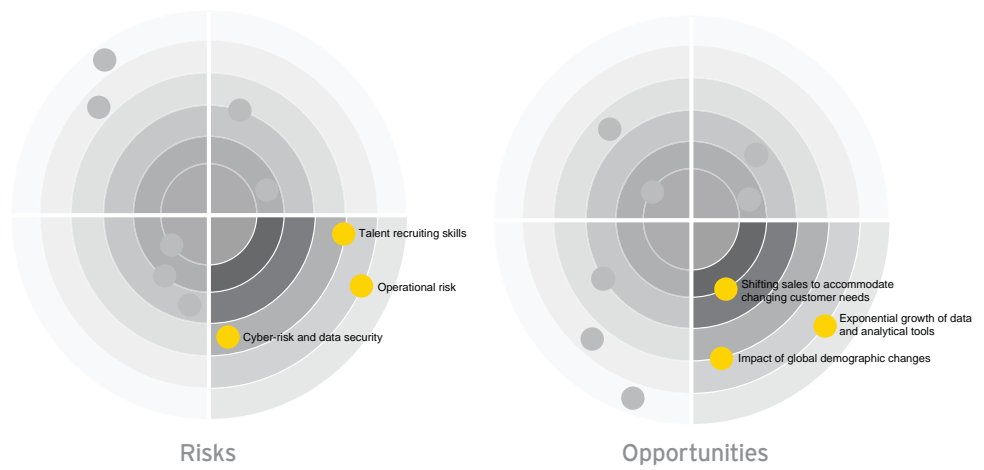
Christopher Wei, Great Eastern Life, Asia Pacific



Operational agility

Keeping one step ahead





Rapidly changing technology is expected to be a source of major risk, requiring insurance companies to be very agile in their response to change. The relatively unregulated, poorly policed world of the internet means that cybersecurity will be a particular threat – and must be taken seriously at the top.

Another key is to recruit people with the skills necessary to tackle online security issues. And, the challenge of maintaining an effective, appropriately skilled workforce is likely to be another risk in the near future. At the senior level alone, regulatory challenges to transparency will put pressure on experienced executives.

While companies are dealing with the problems presented by new technology, they also need to be more responsive to the promise of innovation. The vast swathes of consumer data from online resources, for instance, will be invaluable to insurers – and companies that fail to prepare for these changes will be left behind.

We see real opportunities for companies that are agile and can react swiftly to changing consumer demand and new innovation. Responding to demographic changes will afford many new market opportunities for insurers, at a time when investment income is severely limited.

Cyber-risk and data security: containing the growing threat

Table 15
Ranking from 2013 to 2015

Risk	2013 ranking	2015 expected ranking
Cyber-risk and data security	6	3

How seriously does your company take its online security?

Our survey found that the importance of cybersecurity is well appreciated within the insurance industry. The availability of sophisticated hacking tools on the internet has greatly expanded the pool of people capable of seriously breaching corporate security. At the same time, the difficulty of developing a globally coordinated approach to internet management offers an element of protection to criminals who route their attacks through multiple countries. Add to this the rising threat of state-sponsored penetration of computer networks, and the ease of staging distributed denial-of-service attacks, and it is clear that the extent of this risk will rise in the coming years. Our respondents expect it to be in the top three risks by the end of 2015.

At the retail level, the commercial imperative to meet customer expectations created by other online activities is also increasing. For instance, if one company launches a mobile app, others will feel obliged to follow suit, even if there are misgivings about its security. Moreover, with a deepening focus on customer experience, cyber-risk is complicated by the multitude of online interchanges with customers and the need to protect, as well as analyze, the personal nature of data collected digitally.

We have seen a major shift toward cloud technology, not just for data storage, but also to run key corporate applications. Simply using the latest technology exposes a company to greater risk, despite the potential advantages of cost structure and flexibility. While most are comfortable with this trade-off, security issues are still evolving and must be considered alongside the benefits.

Cyber-conflict engagements profoundly favor the attacker due to a combination of limited attribution, no requirement for

geographic proximity, low cost of entry, and rapid operational pace. Technological advances relating to defenses are likely to lag behind.

The key factor is to ensure an appreciation of cyber security as a due diligence and compliance issue, one that is recognized within the risk management function and regarded as a strategic risk at the highest corporate level. This is clearly a complex issue, but simple moves, such as regular CIO reports to the board and tracking cyber-attack incidents above a certain threshold in the company's key performance indicators, can convey the seriousness with which it is taken at the top.

Talent recruiting skills: where they are needed

Table 16
Ranking from 2013 to 2015

Risk	2013 ranking	2015 expected ranking
Talent recruiting skills	7	5

Are you putting the right people in the right places?

Tackling cybersecurity is likely to require the acquisition of new skills, but insurance companies are also aware of the challenges involved in retaining existing expertise. New levels of transparency that are central to emerging regulatory regimes also apply to compensation and bonuses, making senior executives potential targets of unwelcome shareholder scrutiny. As the consequences of a tougher attitude to executive pay become clearer, we may see a greater exodus from the C-suite. As a result, companies risk losing access to considerable experience, unless they can maintain links with those retiring early through mentoring programs or other mechanisms that can make that experience available to a new generation of leaders.

Outside the C-suite, there is a need for the insurance industry to look at retention strategies for skilled and experienced professionals. Many may have had their job security tested by the wave of redundancies triggered by the financial crisis. Consequently, they may look outside the organization for jobs at competitors or in alternative industries.

“The market dynamic has changed so rapidly that operational risk is currently greater than many companies realize.”

Paul Clark, EY, Asia Pacific

At the specialist level, the need for mathematics and software experts to maximize advances in sophisticated modeling is creating a seller’s market for those with the requisite skills. There is also evidence of strong competition for those with a proven, or even potential, track record of turning the customer-related output of such models into a sales strategy that can target new product niches with effective marketing. Furthermore, the forthcoming imposition of Solvency II requirements has placed a premium on compliance experts. In all these cases, it may well make sense to bring in talent from outside the industry.

Beyond this, many of those we talked to referred to a serious shortage of actuaries, suggesting a need to make insurance a greater area of interest at the college and university level. Further shortages were suggested among specialist underwriters and capital management professionals. Demographic trends make this more pressing, as the college-age proportion of the population is declining in many parts of the world.

Developing markets pose their own set of talent-related risks, with a growing gap between local needs and skills. Paul Clark, EY’s Asia Pacific insurance leader, sees talent as a huge issue in that region, with only macroeconomic conditions and regulation being more important. A shortage of technical expertise in the region is already driving up costs. Additionally, companies need to realize that simply extending existing incentive and bonus schemes to rapid-growth markets as part of an expansion strategy may prove less satisfactory than in home markets.

Operational risk: keeping an eye on traditional risks

Risk	2013 ranking	2015 expected ranking
Operational risk	9	13

Is your organization able to quantify risk effectively?

Two factors, in particular, have renewed focus on operational risk, securing its place in our top 10 risks. The first, linked to a need

to maximize efficiency, is ensuring a positive feedback loop in operational risk management, so that there is transparency on any impact on capital requirements. New regulatory demands will also be a factor over the next couple of years – companies must now demonstrate their ability to quantify this risk for supervisors, who have concerns about issues such as consumer protection.

In terms of both efficiency and compliance, taking the quantification of operational risk more seriously makes sense, particularly with scenario planning and stress testing on the rise. However, it will take a conscious effort to ensure that results are considered at the top of the management structure, where they can inform strategic decisions.

Within rapid-growth markets, the focus of this risk is slightly different. As Paul Clark explains: “The market dynamic has changed so rapidly that operational risk is currently greater than many companies realize.” The emphasis on IT in our survey also raises the question of how much attention is given to an IT outage or failure by those concerned with operational risk. Many companies have well-developed contingency plans for coping with disruption in communications, but a surge of reliance on IT systems, including the increasing use of cloud-based systems, means that these plans must grow and adjust at an even faster pace to ensure business continuity cover.

Shifting sales to accommodate changing customer needs: connecting in a fast-changing world

Opportunity	2013 ranking	2015 expected ranking
Shifting sales to accommodate changing customer needs	3	1

How agile is your business?

Operational agility requires the ability to adapt quickly to any given situation. On the demand side, customer preferences change with economic conditions and lifestyles. Meanwhile, on the supply side, technological innovations create many

possibilities for insurers. An agile company can maximize its advantage by switching approaches based on initial results and response.

Shifting sales and marketing efforts to promote new products will require care and resources, but the fact that our survey places this so high on our list underlines the integrated nature of customer research, product development and sales strategy. A streamlined decision-making process to assess the risks of new product development swiftly, offers a competitive advantage.

The significance of identifying and responding to customer needs reflects the industry's desire for new revenue streams. With investment income sharply curtailed, changing customer needs are driven as much by the need for insurers to find untapped sources of income as by customers finding that their insurance requirements have changed. Brian Suzuki of US-based insurer AAA NCNU sees this as a huge opportunity. "Insurance certainly hasn't been the most customer-driven industry, but as competition gets fiercer, there are going to be a lot of companies looking into different customer segments and making changes in their process, products and technology in order to accommodate the customers they are targeting," he explains.

One region where a shift may be particularly challenging is Asia Pacific, which is more dependent on agents and brokers than other areas. Although Asia is often at the forefront of new technological developments, such innovation in a period of slow growth is a huge risk for insurers. The technological infrastructure varies across the region, so what is appropriate for one country may not be for its neighbor. This is also true of other rapid-growth markets; for example, South Africa where it has become an industry-wide concern. The differing nature of markets within a larger region can make it tempting, but unwise, to extrapolate experience from one to another. Thus, it is crucial that decisions within the company follow a path from market identification to product development and deployment.

New regulations affecting sales practices and commissions in countries such as Europe, China, India and Australia, may reduce the effectiveness of some traditional sales channels. The extent of the shift to new technology will be determined by the success of new product sales strategies, and may depend on the ability to stimulate cross-selling, an area that has been a challenge for insurers. Improvements in processing customer data should contribute to agility. So-called "big data" has a vital role to play

in tailoring products to individual customers, and sales-process techniques will need to shift to accommodate this.

Impact of global demographic changes: long-term shifts with short-term implications

Table 19
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Impact of global demographic changes	7	8

Have you prepared for new markets and new consumers from rapid-growth economies?

As societies become wealthier, fertility rates tend to drop and care of elderly relatives within multigenerational households begins to change. This provides insurance options for health care, nursing home and retirement services. While this is a long-term trend, it has made our top 10 for 2013.

In many countries, events have shaken confidence in state provisions and constrained workplace pension schemes. In China, the shortage of government-provided nursing homes is so severe that some cities are subsidizing private nursing homes to make them more widely available. In Japan, where 12% of the population is above 65, insurers are now offering nursing care and private long-term insurance products.

An aging population in a country with a well-established insurance industry can offer challenges as well as opportunities and requires a careful, yet timely, consideration of the risks associated with new market segmentation. Staying on top of such developments requires multilayered thinking: companies must accurately identify trends, consider the operational impact, and develop tools and processes with which to adapt.

On the heels of a boom in Islamic banking, the market for Islamic insurance (takaful) and reinsurance is also opening up. While much of the demand has been met by specialized institutions in the Middle East and Asia, the market is proving increasingly



“Insurance certainly hasn’t been the most customer-friendly industry, but as competition gets fiercer, there are going to be a lot of companies looking into different customer segments and making changes in their process, products and technology in order to accommodate the customers they are targeting.”

Brian Suzuki, AAA NCNU, US

attractive to some major multinationals. Islamic insurance institutions are organized on a cooperative or mutual basis, with participants coming together to share risks by contributing to a pool that helps those who suffer losses. Any surplus funds are either retained as reserves or distributed to charities, but the operator of the fund usually receives a fee for the work involved, which includes overseeing investments that meet the conditions of Islamic law. As noted in EY’s *World Takaful Report 2012: Industry Growth and Preparing for Regulatory Change*, the global takaful market represented US\$12b in premium payments in 2011.

As awareness of these products extends beyond the Middle East and Asia, the burgeoning Muslim population could become a small, but notable, aspect of general services provided by many insurers. This trend is likely to take longer to emerge than the 2015 timeframe of this report, but efforts to standardize takaful offerings with existing insurance regulations are already under way.

Exponential growth of data and analytical tools: innovation as a strategic imperative

Table 20
Ranking from 2013 to 2015

Opportunity	2013 ranking	2015 expected ranking
Exponential growth of data and analytical tools	9	6

Are you ready to take real advantage of unprecedented volumes of data?

“Technology has gone from being a pure overhead to a strategic must,” as Paul Clark of EY’s Asia Pacific practice succinctly puts it. This is illustrated by the rise of big data or the swift processing of huge amounts of unstructured data that is beyond the capacity of standard software programs. Big data has been made possible by the falling costs of digital storage and processing power.

Much of this data comes from the tracking and integrated analysis of customer data gathered from the use of online resources. It offers the opportunity for organizations to take the focus of research beyond the streamlining of internal corporate processes to product innovation and more effective customer experience. For insurers, this can make a significant contribution to tackling the perennial challenges associated with low customer loyalty and high acquisition costs.

The experience of the retail sector in working with data from bar codes and loyalty cards shows the importance of using skilled data analysts. As with all data sources, the best results are achieved by asking the right questions; companies that appreciate that data analytics can be a creative enterprise rather than an unwieldy extension of the IT department will be the most profitable.

A survey of 369 companies by CIO magazine in 2012, found that a third were conducting searches to hire people with analytic skills for big data projects. In addition to the inevitable skills shortage this creates, the survey also found that the top challenges for big data initiatives were funding efforts, long lead times, difficulty in integrating new data with existing systems, and poor data quality. As companies recognize how big data can contribute to better decision-making through forecasting and predictive modeling, and can help improve product differentiation by increasing understanding of customer attitudes, the cost barriers should shrink.

A challenge in this area is for insurers to remain focused as they take the technology to the point where the data can clearly show what they need to do. As EY’s Paul Clark explains: “Insurance companies tend to believe that they are incredibly good at data. But, turning data into information that is useful and relevant, and then turning that information into something of value for insurers and their clients is something with which the industry is still grappling.” Designing a product that can take advantage of the opportunities highlighted by the numbers is still the vital part of gaining a competitive lead from big data.

“Technology has gone from being a pure overhead to a strategic must.”

Paul Clark, EY, Asia Pacific

What it all means for businesses

Being the first to react to change often proves to be a competitive advantage. A company that has a realistic understanding of its level of agility is better situated to consider its degree of appetite for variability and risk. At a time when it is crucial to meet customers' online expectations, insurers need a greater appreciation of cybersecurity as

a risk management function. As they assess changing demographics, and the risks involved in developing new products, insurers must effectively integrate technology into their core competencies. This will require hiring and retaining talent, expanding the role of the CIO and recruiting specialized insurance skills.



Coping with the consequences of extreme weather

The challenges associated with climate change first made our list of top 10 insurance risks in 2009. This year, it was edged out for the first time by more immediate financial and regulatory concerns. While the sense of alarmed uncertainty about this topic of a few years ago has subsided, it has been replaced by an appreciation that climate issues need to be central to the insurance industry's ongoing plans for the future.

To cite some examples, carbon dioxide concentration levels have risen dramatically from pre-industrial levels and temperatures have increased by 0.8 degrees Celsius within the last two centuries. And this sharp upward trend is continuing. The recent impact of Hurricane Sandy serves as a timely reminder of a pressing issue with real consequences. Sandy hit the eastern seaboard of the US at the end of October 2012, having already left a trail of devastation through Jamaica, Haiti, Cuba and the Bahamas. By the time it was finished, more than 250

had been killed and preliminary estimates put total economic loss at US\$65b, primarily in the US. The scientific community concurs that warmer ocean temperatures and rising sea levels are likely to increase the frequency of such ferocious storms.

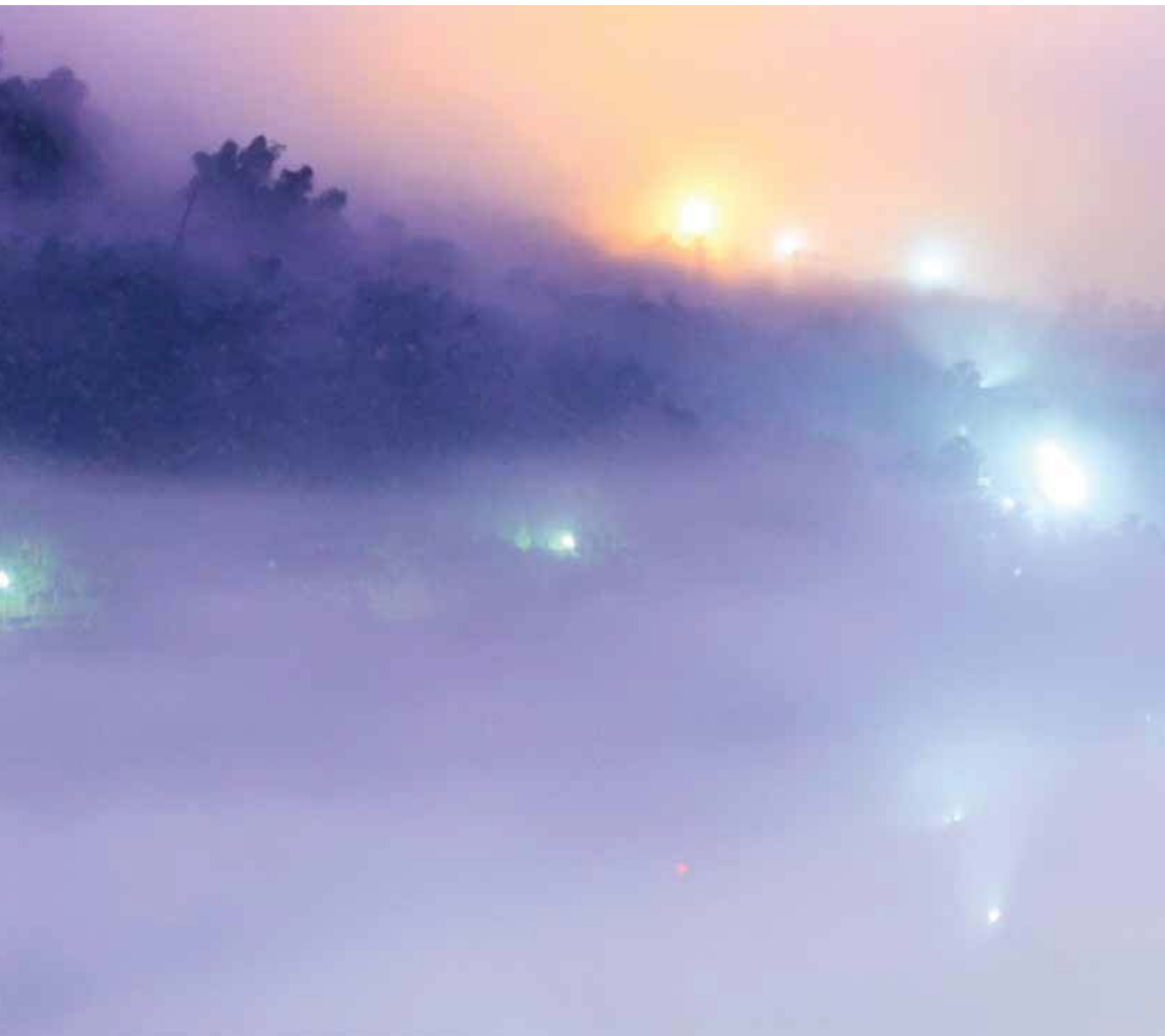
With 2012 confirmed as the warmest year in the US since records began in 1895, momentum is building for significant legislation on greenhouse gas emissions. Another key area of attention among lobbyists is balancing responsibility for natural catastrophes between the public and private sectors. While changes to the law will take time, weather disaster modelers are addressing non-cyclical changes that may affect coverage in the US market.

Currently, the Federal Government takes the lead in providing flood insurance to American households. However, general property insurance premiums for homeowners and businesses in vulnerable coastal zones

will increase as companies change their assessment of risk. While there is a risk that political pushback could lead to tighter restrictions on insurers, new zone changes and building codes should help to mitigate the impact of future storms.

With early estimates putting private insurance claims for storm damage from Sandy at around US\$20b – and the US seeing the largest increase in weather-related losses of any major economy in the world over the last 30 years – insurers in this market will be considering new ways of managing risk that go beyond standard reinsurance strategies. These may include catastrophe bonds or weather derivative contracts.

Emerging challenges





Over the next three years, there are a number of possible geopolitical challenges that could have a profound impact on the global insurance market. These challenges are predictable – and therefore manageable – but they also have the potential to acquire a degree of volatility and unpredictability that may derail strategic and commercial decision-making. Our analysis of these risks, featuring for the first time in this series of reports, is based on input from an expert panel and Oxford Analytica's Global Risk Monitor.

Each of the following emerging challenges may impact the top 10 business risks and opportunities in this report. Therefore, the discussions below offer plausible scenarios for the risk trajectory. We hope that readers will be prompted to reconsider their assumptions about geopolitical contexts, stress-test their company's strategy, and explore the potential interactions between these macro forces and their business implications.

Strong restrictions on international insurance in a major rapid-growth economy

Over the last 20 years, international trade integration has included improved market access for insurance companies. Financial institutions have expanded into rapid-growth economies, both benefiting from, and driving a rising demand for, banking and insurance services. A significant consequence of the ongoing economic crisis has been that the large pool of uninsured and unemployed people has severely curtailed expansion opportunities in social insurance funds and private insurance schemes. This has spurred efforts to tap into the growing middle class in rapid-growth markets.

As a consequence, over the next decade, there is a risk of an increasingly protectionist environment leading to stronger restrictions on international insurance operations in some emerging market governments. Growth in developed countries is expected to be constrained, and aggregate demand in the global economy is likely to remain subdued. This in turn will impact emerging economies, which will see their export markets shrink and could potentially accelerate the development of South-South trade links.

In a number of large rapid-growth economies, including Brazil, India and Russia, recent developments point to a strong resistance to liberalizing financial services. Imposing strict requirements on capital and on cross-border reinsurers may be only the first step, as rapid-growth economy governments seek to support their domestic financial services sectors. As a consequence, and given the diminishing role of the World Trade Organization in driving further integration, some aspects of financial services liberalization may effectively be rolled back over the coming years.

Major global pandemic

Human pathogens, particularly viruses, have the ability to evolve rapidly into forms that can evade the defenses of the human immune system. The same holds true for animal and plant diseases. Despite some improvements in risk management since previous pandemic scares, a new pandemic could overwhelm existing health care capabilities, disrupt economies and generate social turmoil. A significant pandemic event is a potential emerging risk over the next 5 to 10 years.

A number of events could trigger major disease threats in the near future: extension of existing pathogens' habitats, from the tropics toward the poles as a result of climate change; increased pathogen drug resistance due to misuse of antibiotics; or simply the emergence of new pathogens. Secondary factors increasing risk of disease and pandemics include: poor socioeconomic conditions, deficient health care infrastructures, war, migration, urbanization, social upheaval and poor veterinary services.

The insurance industry is one of the sectors most exposed to a crisis created by a pandemic and it would be affected at multiple levels. Insurers will need to consider the potential impact of a global pandemic on their workforce, infrastructure, supply chains and operational capabilities. Furthermore, an immediate sharp rise in payouts for health and life insurance may occur in the event of a pandemic. And finally, businesses and other entities that face supply-chain disruption and broader interruptions to trade and business activities may require a sharp rise in insurance payouts.

Sustained deterioration of trust

Among customers, a generalized fear over long-term economic stability has taken hold. The Eurozone in its current state could negatively influence consumer trust in financial services. As a result, even in the absence of a fiscal catastrophe, life insurance or pension products may lose their appeal.

Similarly, income protection and long-term care products may be seen as more risky and less reliable, and more tangible assets, such as property and precious metals, may become more competitive. This could impact the sale of long-term insurance products and in turn lead to more volatility in insurance.



This volatility could then reduce the economic strength of insurance companies and negatively affect agency ratings. Exiting market segments could experience short-term benefits, but the increased volatility may create long-term risks. For example, a reduction in an insurer's ability to cross-sell products and services may start a negative cycle by increasing distribution costs – leading to a new wave of competitive pressure.

Eurozone adjustment

The unpredictability of the European economic environment could introduce unexpected casualty risks. A “muddle-through” approach that does not require reassessing corporate needs may create a situation where companies suspend preventive and due diligence programs based on expense factors. This may result in casualty risks for which the insurance industry must be prepared.

The survival of the euro is the scenario that carries the lowest political and economic risk, and is seen as a long-term transition toward a new macroeconomic scenario that is less reliant on growth and debt. However, a series of short-term fixes for the Eurozone, which a muddle-through approach would involve, are unlikely to address the systemic issues within its political and constitutional framework.

The macroeconomic transition may be beneficial in the long term, as it preserves stability while allowing for significant change. However, it involves inherent risks for insurance companies, which must retain the ability to assess risk in a changing macroeconomic environment in order to survive.

Climate change and related extreme-weather events

At a time of other pressing concerns, the public view of future environmental threats diminishes. However, climate change continues to pose risks. The International Energy Agency warned last year that, unless governments implement strong measures to significantly increase investment in efficient and low-carbon technologies, the “world will lock itself into an insecure, inefficient and high-carbon energy system.”

Within the industry, tolerance levels have changed and risk management has taken more notice of climate change, but this is a slow process. The time required to turn scientific data into actionable recommendations that can be used by the industry is considerable – and premiums increase because of the uncertainty.

This lack of concrete knowledge about the extent of the risk makes accurate pricing extremely difficult. Comments from insurers operating in the US indicate that, since Hurricane Katrina, companies have mispriced the risk on the high side. As scientists continue to predict the frequency of events, companies will face pressure to lower premiums below the level that scientific data suggests. Furthermore, major weather events are likely to become more frequent in certain areas, which will severely affect rapidly growing insurance markets.

A black and white photograph of a misty mountain landscape. The foreground shows the dark silhouette of a forested hillside. The middle ground is filled with a thick layer of mist or low clouds, partially obscuring the mountain peaks. A bright sun flare is visible on the left side, creating a lens flare effect across the scene. The sky is overcast with soft, diffused light.

Methodology

Risk and opportunity identification

The initial stage of the process involved identifying key risks and opportunities, both for global businesses across sectors and within each sector itself.

For each sector, as well as for the global report, we spoke to at least five experts in each field, asking them to identify what they thought were the leading risks and opportunities for the 2013-15 period.

We asked the interviewees to focus particularly on risks and opportunities for multinational, global organizations within their sector. We narrowed the final list down to 15 risks and 15 opportunities per sector, which were then used as a basis for ranking in the next stage of the process.

Ranking the top 10

For the insurance sector, this stage involved a large-scale survey of 65 companies across the world. For the survey, we asked whether individual risks and opportunities within the report were important for their organization both now and in two years' time.

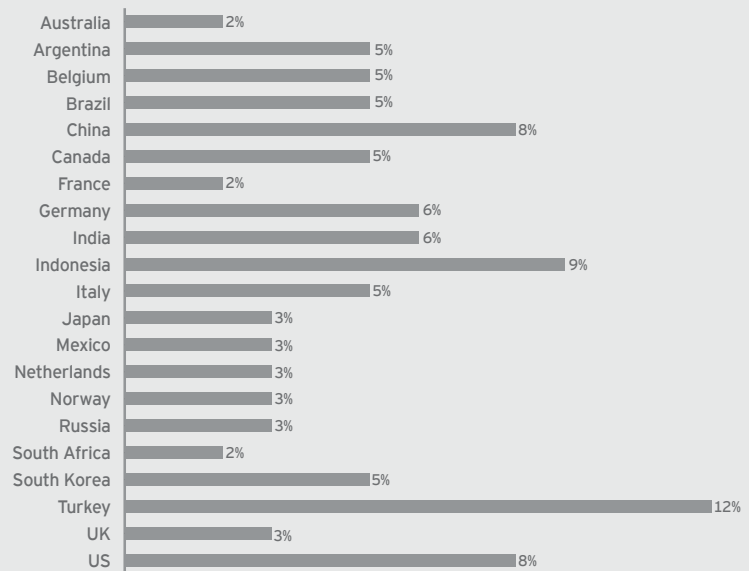
Respondents to the survey rated each risk and opportunity between 1 (not important) and 10 (extremely important). The results were then aggregated. The 10 risks and opportunities with the highest mean score then became our top 10 risks and opportunities.

Understanding the impact of and firms' response to the top 10

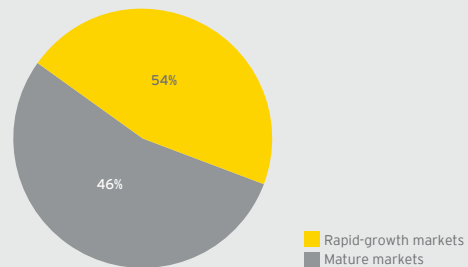
We then interviewed a number of senior executives at major organizations to help us understand how individual firms see these risks and opportunities impacting them, and how they go about responding to individual risks and opportunities.

We also interviewed our own EY practice professionals to get their take on the impact of these risks and opportunities, and how they see firms responding to them.

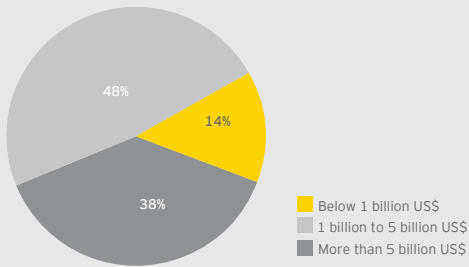
In which country is this interview taking place?



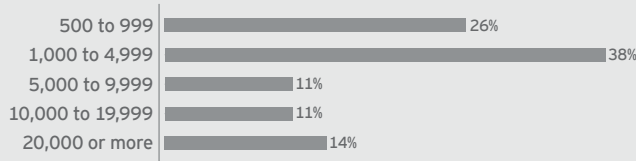
In which market is this interview taking place?



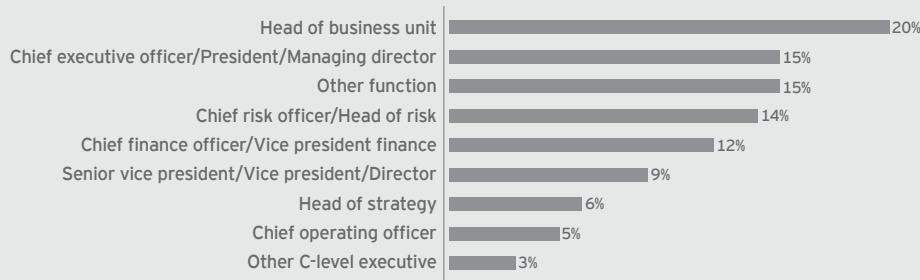
What was the sales revenue (roughly) worldwide?



How many employees does your organization have?



In which function do you work professionally at the moment?



Appendix

Risks and opportunities below the radar

The risks and opportunities that formed part of our top 15, but did not make it into the top 10 following our large-scale survey, are listed below.

Risks

11. Elimination of rating factors
12. Business model innovation (threat of emerging competitors)
13. Climate change, natural catastrophes and global pandemics
14. Terrorism
15. Technological and medical advancements (hydraulic fracturing, nanomedicine)

Opportunities

11. Growth in number of large-scale infrastructure projects
12. Global rise in the number of high net worth individuals
13. Geopolitical trends increasing need for political risk insurance
14. Generational wealth transfer
15. Shift in funding for retirement or pension to private sector and individuals





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