2017 US life-annuity insurance outlook

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2017: a market in transition

The coming year will be a year of continued disruption for the US life-annuity insurance market. The industry will remain in flux as customer demands evolve, digital technology advances and InsurTech innovation gains momentum. Today's low interest rate environment and slow growth will continue in 2017, as will the regulatory pressures on consumer protection, capital and cybersecurity.

However, the Trump presidency adds another layer of uncertainty. With the Republicans now in control of the White House and both chambers of Congress, a sharp shift in economic and regulatory direction is likely. Trump's economic agenda, which includes tax cuts and higher infrastructure spending, could result in higher growth and interest rates in 2017. In addition, insurers may benefit from a wave of deregulation that could affect rules now on the table, from Dodd-Frank to fiduciary standards proposed by the Department of Labor (DOL).

Despite the uncertainty, throughout the year, insurers will continue to draw on robotics and other technologies to drive cost efficiencies across the back and front offices. Insurers will need these savings, not just to boost margins but also to free up funding to drive future innovation and growth. With change coming from many directions, insurers will stay focused on the customer while reassessing the competitive positioning in light of market trends. For some, it may be a time to make brave strategic bets and rethink future plans.

Economic uncertainty ahead

The Trump presidency raises questions about the future course of the economy in 2017. US growth had been expected to rise from roughly 1.4% in 2016 to about 2.1% in 2017. If Trump pushes through his agenda of slashing taxes, boosting infrastructure spending, and taking strong protectionist measures, then US growth could suffer from wider budget deficits and slower trade. On the other hand, if Trump were to move more prudently on tax cuts and spending, and soften his stance on trade, economic growth could exceed expectations. On the global front, the impact of Brexit and a slowdown in emerging market growth add to the economic uncertainty.

Swiss Re Sigma now forecasts that in-force real premium income for life insurance (the amount a life insurer underwrites based on premiums collected on active policies, adjusted for inflation) will rise by 2.3% in 2017, representing a marked improvement over the negative growth of 2013 and 2014, and up from 2016 forecasts. Much of the growth in 2016 can be attributed to a pick up in demand for direct life products and accident and health insurance, as opposed to a rise in premium prices or sales of annuities. For example, according to the National Association of Insurance Commissioners, over the period of Q2 2015 to Q2 2016, life direct written premiums grew 1.8% and accident and health increased 4.6%, while annuities went up only 0.2%.

In-force real premium income growth for life insurance*

Country	2013	2014	2015E	2016F	2017F
US	-7.1%	-1.7%	1.3%	1.0%	2.3%
Canada	3.0%	7.6%	3.4%	3.5%	3.8%
UK	-5.9%	-10.4%	3.3%	3.5%	3.2%
Japan	-6.8%	7.1%	2.7%	3.0%	3.7%
Australia	9.8%	26.5%	-5.8%	4.1%	2.1%
France	3.6%	8.4%	4.2%	2.6%	2.5%
Germany	2.5%	2.7%	3.1%	0.9%	0.9%
Italy	20.6%	29.5%	2.8%	2.2%	2.3%
Spain	-4.3%	-2.5%	-11.6%	0.3%	0.6%
Netherlands	-5.9%	-5.2%	-10.0%	2.2%	1.7%
Advanced markets	-2.5%	4.2%	1.9%	2.4%	2.6%
Emerging markets	4.0%	7.4%	10.6%	10.7%	10.7%
World	-1.5%	4.7%	3.3%	4.0%	4.2%

E = Estimate, F = Forecast

Note: this table provides growth rates for life business alone (i.e., excluding medex). The emerging market chapter provides growth rates for the life and health (L&H) businesses together.

Source: Swiss Re Economic Research & Consulting.

* The amount a life insurer underwrites based on premiums collected on active policies, adjusted for inflation.

> "A prolonged period of low growth and low interest rates could … put at risk the solvency of many life insurance companies."
>
> IMF Executive Board, 23 September 2016

While year-on-year premium growth for US life and annuity insurers is expected to remain lower than other advanced markets, a pickup in US GDP growth for 2017 would be good news for both life and annuity insurance lines. Meanwhile, health insurers will benefit from any policy shift that will generate upward pressure on premiums and rising demand for private insurance products.

Going forward, demand for life insurance, particularly for whole life insurance, is expected to strengthen as customers seek greater safety in a volatile financial environment. According to a recent study by LIMRA, a worldwide insurance association, 34% of Americans are at least somewhat likely to buy life insurance in 2017. At the same time, any rise in long-term interest rates, which now look more likely under a Trump Administration, will help stimulate demand for annuity products. As profitability in the sector is highly correlated to changes in interest rates, any increase in bond yields would provide much-needed relief to insurers struggling to maintain margins.

Low bond yields have been the biggest problem for insurers for several years. Most economists expect a modest improvement from 1.7% in 2016 to more than 2% in 2017; even if Trump's agenda were to buoy rates further, it still would not be enough to raise portfolio yields materially. While some insurers have moved into market equities to gain higher returns, the majority (roughly 74%) of all invested assets of life insurers is in bonds. With savings products now accounting for a whopping 65% of premium revenue, insurers are closely examining the value of their savings products in an uncertain interest rate environment. Against this backdrop, it is not surprising that Fitch Ratings revised its outlook for US life insurers to negative in September 2016.

A complex regulatory landscape

While the future of DOL fiduciary rules are now in question under a Trump Administration, if they go through in April as planned, they will have dramatic financial and operational implications for US insurance companies and their agent networks. For many insurers, the new rules will cause seismic shifts in distribution channels and costs, while creating product design challenges and opportunities for plan manufacturers. Under the rule, any advisor or agent who recommends an investment or insurance product to a plan or an IRA will become a fiduciary. As a result, prohibited transaction rules in the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) will prohibit the agent or advisor from receiving any compensation, unless exemption conditions are met. In order for agents to receive commissions on product sales, they must qualify for a "best interest contract exemption" (BICE). The greatest impacts will be a move to a level commission or fee-based structure and substantial compliance costs. Annuity sales may also be hurt, given the more complex sales process and the elimination of some sales incentives.

Full compliance will not be required until 1 January 2018; however, many companies are already implementing new compensation and sales frameworks. At the same time, new oversight intermediaries are attempting to move into the insurance value chain to offer supervisory and compliance services. (BICE requires that a fiduciary advisor or agent be supervised by a "Financial Institution.") "Independent Marketing Organizations" (IMOs) are applying to the DOL for financial institution status to act as fiduciary supervisors (17 to date) of independent agents who distribute life-annuity products. While potentially eliminating an even more expensive oversight problem from product manufacturers, this is likely to add cost to the value chain.

2017 is also likely to usher in more government action on cybersecurity at the federal and state level. For example, recently proposed cybersecurity regulations from New York State, as well as from the Federal Reserve, Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, are harbingers of things to come. Under a Trump presidency, cybersecurity is likely to be given higher priority because of its role in national security.

Adjusting to evolving customer expectations

Converging demographic, regulatory and technological changes, together with the rapid rise of InsurTech, are raising customer expectations for a more personalized, transparent and digital customer experience. With the number of smartphone users in the US estimated to rise above 200 million by 2017, the requirement for anytime, anywhere, any device access will become pervasive. Customers will increasingly demand transparency when comparing products, self-directed online platforms that provide them with interactive tools, and more coordination around "financial wellness" and benefit options over time.

Adapting approaches will be particularly important for reaching younger customers, such as GenXers and Millennials, who will matter more for life insurers in 2017. According to Elaine Timicki, Corporate Vice President of Insurance Product Research at LIMRA, nearly three-quarters of new life insurance buyers are now under age 55, and 4 in 10 life insurance policies are now purchased by consumers aged 25 to 45. To reach these younger generations of buyers, mobile and internet-based distribution will be essential.

> "Insurers are looking at different technologies. They are looking at machine learning to make underwriting decisions. They are looking at all kinds of data, from medical to behavioral. They all know that they cannot take months to underwrite a policy. They need to do it in days — and soon, even quicker."
>
> Douglas French, Managing Principal, Ernst & Young LLP

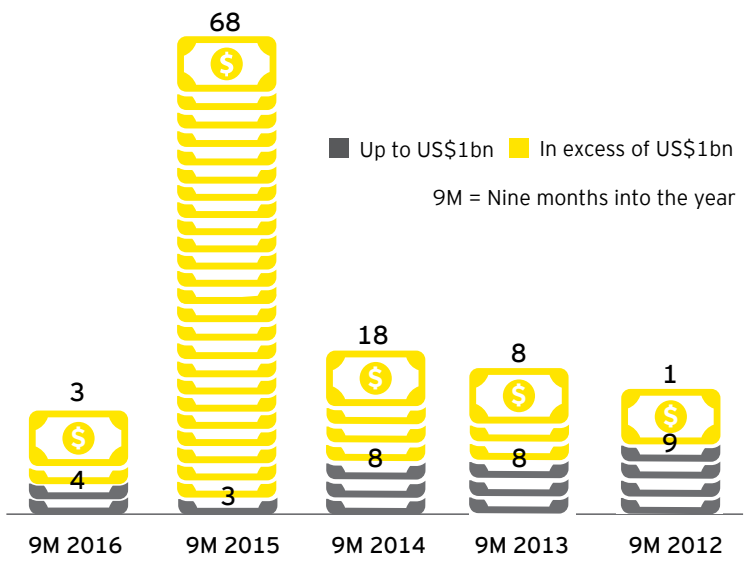
A J.D. Power study released in October found that 27% of life insurance customers — and 33% of baby boomers — are now communicating with their life insurers via digital channels in 2016.

InsurTech will continue to influence the life-annuity insurance industry in 2017. With US$4.6 billion in funding, the range of InsurTech innovations will widen to include online platforms for conducting insurance comparisons; simplified online offerings of life insurance; and wellness and prevention insurance. To meet customer expectations with faster, less intrusive and consistent underwriting practices, life insurers will invest more in algorithmic technology and predictive analytics. Meanwhile, the increased use of robotics promises greater streamlining of transaction activities. Insurers will also increase their use of technology to understand customer needs, identify cross-selling opportunities and provide a seamless customer experience. To drive further innovation, insurers will experiment with smart technologies, such as artificial intelligence and blockchain.

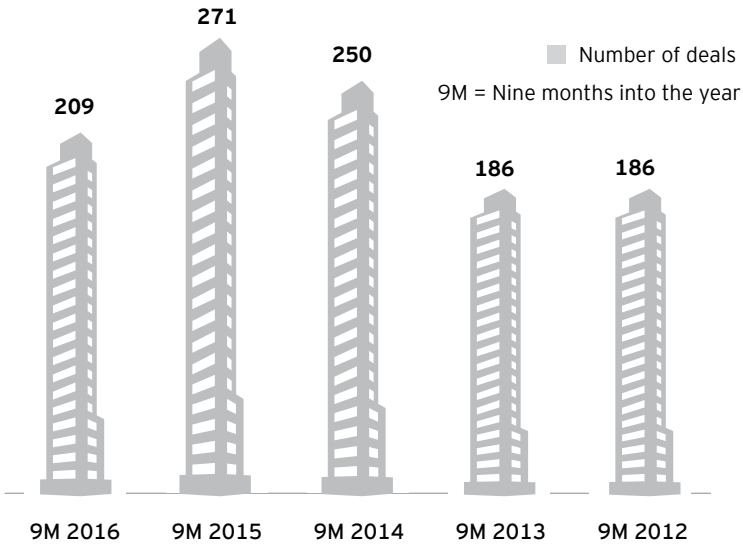
In the face of these shifts, life-annuity insurers will continue to reassess their market strategies in 2017 and rethink traditional products with new hybrid configurations, such as long-term care with life policies or annuities. Some may seek to build scale, distribution and InsurTech capabilities through M&A, partnerships and greenfield initiatives, while others may spin off business activities for regulatory and strategic reasons. These strategic moves, together with a proliferation of InsurTech start-ups, will add to competitive pressures in 2017.

A more accommodative regulatory environment and the need to drive growth may keep M&A activity brisk in 2017 in terms of deal volumes. However, smaller insurance brokers may be less equipped to meet the DOL's tighter fiduciary rules, leading to greater market consolidation. Deal size in 2017 will likely be similar to transaction values in 2016, which fell dramatically over the first nine months. This can be explained by a significant reduction in the number and size of deals by Asian investors into the US insurance sector.

Deal value (US$b)



Deal volume



Source: EY global insurance M&A activity in the nine months to September 2016.

New risks on the radar

Digital transformation, combined with the rise of cybercrime and terrorism, will expose life insurers to an unprecedented level of cyber risk in 2017. In a recent EY survey, most CROs in US insurance companies reported that their organizations face a high risk of suffering a cyber attack or data breach. This is not surprising given the rich personal data that life insurers hold. In 2017, as regulatory scrutiny and customer expectations increase, life insurers will take stronger measures to protect their companies from cyber risks. Cyber risk audits, enterprise-wide training, vulnerability scanning, penetration testing and war gaming to assess responses to simulated cyber attacks are just some of the new tools and techniques that insurers will apply.

In 2017, CEOs will also need to address a bigger strategic risk for their business – the widening talent gap. While not a new issue, insurers have not done enough to develop the critical workforce skills required in an evolving competitive and regulatory landscape. The needed talent runs the gamut: in addition to data scientists, risk modelers, compliance specialists and cyber risk experts, firms will require expertise in emerging technologies, such as predictive analytics, artificial intelligence and blockchain, as well as new go-to-market approaches, such as digital marketing and social media. Perhaps most crucially, companies will need to confirm that their management teams have the right abilities and mindsets to drive the next stage of digital transformation and innovation.

Life-annuity insurers will need to compete with other industries to find Millennials with these skills. Adding to the challenge, attracting foreign talent may become more difficult if the Trump Administration tightens immigration policies.

Impact of external factors on the US life-annuity market in 2017 (1 = low impact, 10 = high impact)

9	**Regulations**	If they take effect in April 2017, the new DOL fiduciary rules will have serious implications for distribution channels, costs and product design. New cybersecurity regulations at the national level will further complicate the regulatory landscape. A Trump Administration will bring a change in the regulatory agenda.
8	**Customer expectations**	The convergence of demographic, regulatory and technological change will raise expectations for a more digital, personalized and seamless customer experience. Simpler products and a holistic financial orientation will become prerequisites as insurers strive for true customer centricity.
8	**Technology**	Insurers will continue to drive cost savings and innovation through core technologies, such as robotics and analytics, while exploring new tools such as artificial intelligence and blockchain. Incumbents will be keeping a close eye on InsurTechs, which now have US$4.6 billion in funding.
7	**Cyber risks**	Ongoing digital transformation and cybercrime will expose insurers to unprecedented levels of cyber risk. Developing a robust cyber strategy will be critical, not only for complying with regulations and protecting customer information, but also for building customer confidence and brand reputation.
7	**Competition and M&A**	Facing continued disruption, insurers will reassess their market position and explore M&A options, partnerships and greenfield investments to meet strategic objectives. Acquiring distribution channels, spinning off unprofitable businesses and teaming up with InsurTechs to improve long-term positioning will be top of mind.
6	**Economy**	Stubbornly low interest rates, combined with mediocre US growth, will put continued pressure on insurers' margins, investment returns and credit fundamentals. A new Trump Administration adds greater economic uncertainty, with economists divided on the potential impact.
6	**Talent**	With insurance professionals retiring, and digital transformation accelerating, insurers will face a wider talent shortfall in 2017. Forward-looking insurers will focus on attracting and retaining data scientists, cyber risk specialists and other talent to capture their future.

Strategic priorities for 2017

With Republicans now in control of the White House and both chambers of Congress, we may see a major shift in policy direction that could redefine next year's business environment for insurers. Whatever the outcome, the interplay of emerging economic, regulatory and technological shifts will continue to disrupt the life and annuity business in 2017. The impact of these changes will be felt across organizations — from compliance, risk and asset management to product development, back-office operations and advisor roles. To navigate through this uncertainty, life insurance executives should set the following strategic course for their firms:

1. Prepare for regulatory change
2. Stay centered on the customer
3. Re-evaluate strategies for a changing marketplace
4. Take digital transformation to the next level
5. Make cybersecurity a top strategic priority
6. Close the talent gap

1 Prepare for regulatory change

Develop a strategy to comply with new DOL fiduciary rules and be prepared to course-correct. Understanding the impact of the new DOL rules can be challenging, since they affect nearly all components of strategy, operations and distribution. Adding to the complexity, these rules may be reassessed under a new Trump Administration. Until the dust settles, management teams should consider the following approach:

- Revisit the core business strategy and revenue model — for example, consider moving to a fee-based advisory model
- Re-evaluate distribution channels and go-to-market strategies
- Map out customer touch points, from initial contact to point of sales to ongoing service interaction
- Re-examine the advisor model to verify that investment advice is objective and well documented
- Adjust product and service offerings targeted by the DOL rules, such as IRA rollovers
- Upgrade your operating model to improve compliance and customer transparency
- And verify that your team, including brokers and agents, has the right skills for the future, along with proper training and certifications

Confirm your internal systems can keep up with regulatory change. From rules on consumer protection and transparency to financial solvency and cybersecurity — and now a potential shift in overall policy direction – the regulatory landscape for life insurers has never been more complex. To keep up and comply with changing regulations, insurers will need to build advanced data management and analytics capabilities, extract more value from governance, risk and compliance (GRC) systems, and synchronize their three lines of defense among business operations, oversight teams and independent auditors. Announcing new procedures is not enough; best-in-class firms will closely monitor regulatory developments at the state, federal and international level, and assess how well employees are complying with new rules on an ongoing basis. Establishing a fully trained compliance team with input into strategic business decisions will be essential.

> "The DOL may be a game changer for life-annuity insurance companies. Insurers will need to rethink key fundamentals of their business, from compensation models to distribution and sales processes. What worries insurers most is that they don't yet know how to ensure that advisors are always acting in the customer's best interest."
>
> Mark Hopkins, Executive Director, Ernst & Young LLP

2 Stay centered on the customer

Apply analytics to gain deeper customer insights. The customer provides a valuable compass to companies mapping a strategy for changing times. But understanding and addressing the diverse needs of four generations of clients is not easy: it requires advanced analytical tools to search through reams of scattered data to uncover customer insights. In 2017, insurers should further integrate customer information systems across the enterprise and distribution channels to gain a more complete picture of their customers. By drawing more on segmentation, behavioral and predictive analytics, they will be able to identify sales and new product opportunities, both among existing clients and new ones.

Create a strong cross-channel customer experience. Insurers need to catch up with other financial institutions in meeting the rising expectations of customers, who are becoming more digitally connected, self-directed and better informed. "The industry knows it's behind in delivering a strong customer experience," says Douglas French, Managing Principal of Insurance and Actuarial Advisory Services at Ernst & Young LLP, "and will work on upping its game in 2017." Specifically, insurers will create digital platforms and mobile apps that simplify interactions, provide a more personalized service and offer better access to data. To engage customers – particularly younger ones – insurers are likely to focus more on social media programs and communities that promote health and financial well-being.

Rethink go-to-market approaches to meet changing investor needs. With margins under pressure and customer buying behaviors evolving, insurers will continue to reconsider distribution approaches in 2017. Insurers will look for new ways to improve customer engagement and act more as advisors for their "financial health" while experimenting with direct selling platforms designed for specific customer segments. Product innovation will also be top of mind, with insurers providing new prevention-based insurance, hybrid products that combine benefits and other new offerings.

3 Re-evaluate strategies for a changing marketplace

Reassess your strategic positioning for the years ahead. With the industry in transition and a new administration taking office, this is an ideal time for management teams to assess their current market position carefully and decide where they would like to be in the long term. According to Mark Hopkins, Insurance Innovation and Growth Executive Director at Ernst & Young LLP, insurers need to ask themselves a central question: what market segments will be the most important to my company in the future? "There is a wide spectrum of choices right now," says Hopkins. "Should we focus on servicing clients at retirement, in retirement or approaching retirement? Or do we want to be the number one company with Millennials? Your answers to these questions will define your products, distribution channels and business strategies in the future."

Use M&A to improve competitive positioning for the future. To cope with ongoing low interest rates and other market strains, insurers will continue to explore M&A opportunities in 2017. "Insurers will use M&A to strategically reposition their business around the areas of manufacturing and distribution they want to be in. It will be less about Company A merging with Company B, and more about targeting component pieces within Company A and Company B." According to Hopkins, executing on M&A can be difficult in today's marketplace: "One M&A problem for life-annuity firms in the US is that the economics may not work. In this environment, even agreeing on the principles of valuation on portfolios and products can be challenging."

Find the right InsurTech strategy for the firm. After making considerable progress this year, insurers will take further steps to cultivate their InsurTech capabilities in 2017. Some will build InsurTech into their business models through acquisitions and partnerships, while others will create internal innovation labs to weave InsurTech into the fabric of their businesses over the longer term. The key will be to find the right solution to the inherent InsurTech paradox: Start-ups need to be nimble and responsive to thrive in a dynamic marketplace. But they also need a rigorous compliance infrastructure and a history of financial strength to compete in a highly regulated marketplace. A collaborative approach offers a win-win situation to InsurTechs and incumbents. The competitive threat will not come from InsurTech start-ups, but instead from incumbents that move first into the InsurTech space.

4 Take digital transformation to the next level

Use technology to improve your current business approaches. Margin compression will encourage insurers to continue to find new efficiencies. They will continue to scour their end-to-end operations for ways to cut costs and boost profits – from automating back-office operations to creating digital interfaces with customers and distributors. Algorithmic underwriting, robotic process automation, digital cross-selling and digitally enabled customer experiences are all on next year's agenda.

Get control of data across the extended enterprise. To facilitate analysis, insurers will go further to organize high volumes of scattered data into accessible, consistent formats. This should include data held within the enterprise and across distribution channels. Improving data and analytics will not only help insurers meet regulatory and customer pressures, it will also allow them to build a framework for the next stage of digital transformation. Focusing on advanced analytics is crucial: as one CEO said, "We don't have a data problem; we have a data leverage problem."

Prepare for the next phase of digital innovation. 2017 will be a year of continued experimentation, and the focus of innovation will start to shift from reducing costs to reinventing products and business models. Insurers will explore new approaches, such as lifestyle monitoring and prevention and reward programs, and look deeper into game-changing technologies, such as artificial intelligence, blockchain and behavioral analytics. Developing pilot programs and use cases for these technologies will be a priority, since they will spur this next phase of insurance innovation. To make this happen, CEOs and management teams will need to tackle a fundamental challenge: nurturing a culture of innovation that encourages new thinking and collaboration.

5 Make cybersecurity a top strategic priority

Draw on technology and people to secure data. Given the tremendous amount of personal and health data that resides in insurance firms, and their complex vendor relationships, building a robust data security system is both crucial and challenging. "As insurers move into the digital world," says Hopkins, "there will be many more access points to sensitive customer information." He sees four key ways to achieve system security: "First, secure your data. That is job one. Second, identify the firm's risk exposure and how to manage it. This involves identifying whether the exposure lies internally or externally. Third, develop a fine-tuned mechanism for threat detection and response. Finally, to bring this all together, confirm you have the skills in place across the ecosystem, since companies are only as strong as their weakest link."

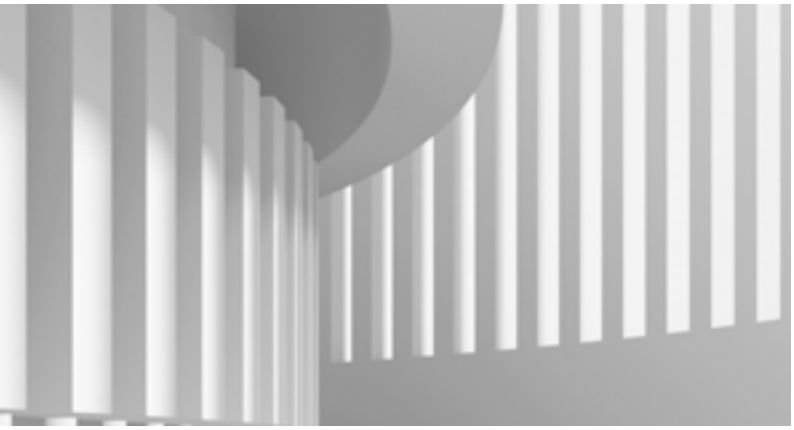
Make cybersecurity a continuous business activity. One challenge with cyber risk is that it constantly evolves. As hackers find new ways around safeguards, cybersecurity systems need to adapt quickly. Ongoing cyber audits, stress tests, vulnerability scanning and war gaming to assess staff responses are just some of the techniques insurers are using to verify ongoing protection. According to EY's Douglas French, "Insurers will also need to leverage the right technology, from security detection to micro-segmentation tools, and provide ongoing training to staff, since human error can cause many of the problems." One final option, according to French, is setting up insurance exposure plans to transfer risk to the reinsurance or insurance markets.

6 Close the talent gap

Make 2017 the year to build new talent management strategies. Transforming the firm's business will not be possible if it lacks the needed talent. "Without the right people, you can't deliver on any of the firm's strategic imperatives," says EY's Douglas French. "Insurance companies will need to rethink the strategies for attracting, developing and retaining talent if they are to succeed in a fast-evolving financial industry."

Assess whether the firm has the needed talent for the future. 2017 is the year to determine the critical workforce skills that insurers will need to drive the business forward, according to EY's Hopkins. "Crucially, insurers should develop a very clear human capital strategy that spells out the skills that will be absolutely critical to have in-house, and the ones they can get from partners. They should also have a view on future of work, and which tasks will require humans and the ones that can be handled by machines. You may not be able to accomplish everything in 2017, but at least you will have a framework to inform future hiring decisions."

Create clear pathways to transfer knowledge. Creating a culture of collaboration and a team approach will also be critical to achieve a transfer of technical and digital knowledge between seasoned professionals and new hires. Equally, linkups with InsurTechs through partnerships, acquisitions and VC investments could be a quick way for insurers to come up the learning curve. Bringing in digital experts in critical areas, such as advanced analytics and cybersecurity, and developing greater collaboration between internal teams, such as the CRO and CIO, will also be essential.



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