



2019 Insurance Outlook

Growing economy bolsters insurers, but longer-term trends may require transformation

Deloitte Center *for*
Financial Services



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Where do insurers stand as they enter 2019?

Sustained economic growth, rising interest rates, and higher investment income are among the positive factors that appear to be bolstering insurer results in 2018, setting the stage for enhanced top- and bottom-line growth in the year ahead.¹ The US property and casualty (P&C) side of the business got off to a particularly good start in the first half, with net income more than doubling compared to 2017 (see figure 1).²

Although global consolidated figures for 2018 will not be available until the middle of 2019, data for the end of 2017 suggest that the non-US insurance industry is also growing, but perhaps not as quickly as its American counterpart, likely due to faster US economic expansion and lower unemployment.

In the P&C sector, US premiums written grew 4.6 percent in 2017, the highest percentage in the past decade,³ before jumping by 12.7 percent in the first half of 2018.⁴ Growth is not nearly as robust globally—indeed, Swiss Re’s Sigma reported that advanced markets, even including the faster-rising US region, saw premium growth of just 1.9 percent last year.⁵ Although premiums increased at a much healthier rate

of 6.1 percent in developing markets, that figure was down from 2016’s 9.8 percent, thanks largely to China’s growth rate being cut by half to 10 percent.⁶

US P&C carriers have seen their insurable exposure base continue to expand for both personal and commercial lines, likely thanks in part to faster GDP gains, a shrinking unemployment rate, and higher consumer spending. But there has also been some luck behind improving results, as insurers enjoyed a welcome first-half respite from record natural disaster losses—down globally by one-third to \$17 billion compared with the same period in 2017.⁷ This should cushion the financial hit from second-half catastrophes, such as Hurricane Florence, which caused major flood losses but perhaps \$5 billion or less in insured damages, and Hurricane Michael, where insured loss estimates ranged between \$4.5 billion and \$8 billion as this report was compiled.

Reinsurers in particular seemed to have regrouped, with the Reinsurance Association of America reporting first-half net premiums up by one-third and the combined ratio a profitable 96.1.⁸

Figure 1. 2018 first-half US P&C industry results

P&C insurer benchmarks improving in first-half

Metric	P&C sector, 1H 2018 results
Net premiums written	↑ Increase of 12.7%
Underwriting results	↑ 300% turnaround, from a \$3.7B 2017 loss to \$6.7B gain
Combined ratio	↑ Improvement from 100.8 to 96.4
Net investment income	↑ Grew 12.2%
Net income	↑ More than doubled to over \$34B
Consolidated capital and surplus	↑ Rise of 6.5% to \$772B

Source: Deloitte analysis of consolidated industry results from S&P Global.^a
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Unfortunately, those in the US life insurance and annuity (L&A) business have generally not fared as well as their P&C counterparts (see figure 2), although the sector appears poised for a rebound. Individual US life insurance sales grew in the second quarter by 2 percent, after three straight quarterly declines.⁹ Indexed universal life led the way with 15 percent growth.¹⁰ Globally, life insurers continued to struggle, at least in advanced countries, where premiums fell 2.7 percent last year. Developing countries, on the other hand, saw sales rise 14 percent, although on a much smaller premium base.¹¹

However, the outlook for annuities appears to be a lot brighter, thanks primarily to rising interest rates and increased disposable income. Total US annuity sales are forecast to rise between 5 and 10 percent for 2018—and gain another 5 percent next year.¹²

Longer-term, more robust growth rates could materialize if Congress approves a bipartisan bill—the Retirement Enhancement and Savings Act—that would, among other provisions, make changes to encourage distribution of 401(k) balances via annuities into guaranteed lifetime income streams.¹³ Annuities could also likely continue to get boosts from pension risk transfers, with single-premium,

private-pension buyout sales rising 68 percent last year to \$23 billion,¹⁴ and already up 76 percent in the first half of 2018.¹⁵

Looking ahead to 2019

While improving economic conditions this year may have brightened the short-term outlook for insurers in 2019, for many insurers, a rising tide won't necessarily lift all boats equally. There are still plenty of challenges to overcome in the year ahead, as well as opportunities to improve a carrier's competitive position and bottom line. In this report, we spotlight some of the highest-profile issues insurers will likely be called upon to deal with in technology, talent, regulation, product development, mergers and acquisitions, and tax reform. We reflect on how each element is likely to play out over the next 12 to 18 months and offer some suggestions on what insurers should consider doing in response.

The underlying message is that while the industry may have to cope with a plethora of internal and external pressures, their impact remains very much in each insurer's own hands. Perhaps the biggest determining factor will be how committed and prepared each insurer is to adapt quickly to a rapidly changing economy and society.

Figure 2. 2018 first-half L&A results

L&A insurers struggle for traction, but growth prospects brighter

Metric	L&A sector, 1H 2018 results
Premiums	↔ Virtually no growth
Net investment income	↑ Increased 4.4%
Net income	↓ Declined 12%
Life insurance applications	↓ Decreased 0.3%*

Source: Deloitte analysis of consolidated industry results from S&P Global.^b
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*MIB Life Index

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Spotlight on the economy

Recession could put a damper on insurer growth by 2020

While 2018 and 2019 are shaping up to be banner years for insurers, some concerns are being raised about an economic slowdown, if not a full-fledged recession, as early as 2020. Many are worried about the potential for ongoing disputes between the United States and China as well as other nations over tariffs and trade rules. Meanwhile, some expect the economic stimulus from federal tax cuts and additional government spending to peter out by 2020, while rising interest rates could perhaps discourage consumer borrowing, housing construction, and business expansion. In fact, Vanguard recently warned that the chances for a recession by late 2020 are between 30 and 40 percent.¹⁶ One warning sign cited by economists was a flattening yield curve between short- and long-term interest rates—a development that has historically indicated a recession ahead.¹⁷

It would therefore be prudent for insurers to maintain their growth momentum by continuing to focus on improving operational efficiency, boosting productivity, and lowering costs with new technology and talent transformations, while customizing products and services to meet the evolving demands of the emerging digital economy.



Technology trends

Insurers appear poised to leverage cloud, blockchain

Why should cloud be high on insurer agendas in 2019?

For many insurers, the cloud-computing debate is over.¹⁸ With 7 in 10 carriers using cloud in their business today, it is already an integral part of their technology environment and business platform strategies.¹⁹

The traditional drivers of cloud computing—cost savings and pay-as-you-consume contracts—will likely continue to push usage. Yet the next round of adoption will likely be driven by other key benefits that cloud offers—namely speed, flexibility, and scalability.

Insurance CIOs, who are under pressure to deliver digital capabilities, are looking at developing applications on the cloud as a faster alternative to on-premises deployments.²⁰ Beyond that, evolving technologies such as advanced analytics, telematics monitoring via the Internet of Things (IoT), and cognitive applications generally demand newer technology capabilities that are both quickly scalable and flexible, given the amount of data being generated and the processing power needed to leverage it.

Cloud providers seem to be actively evolving their capabilities to offer advanced solutions in partnership with system integrators to create industry-specific solutions.²¹ Carriers have an opportunity to be part of this ecosystem of partners to gain a competitive edge by drawing timely insights from data in a cost-effective manner.

Where is cloud heading in the next 12–18 months?

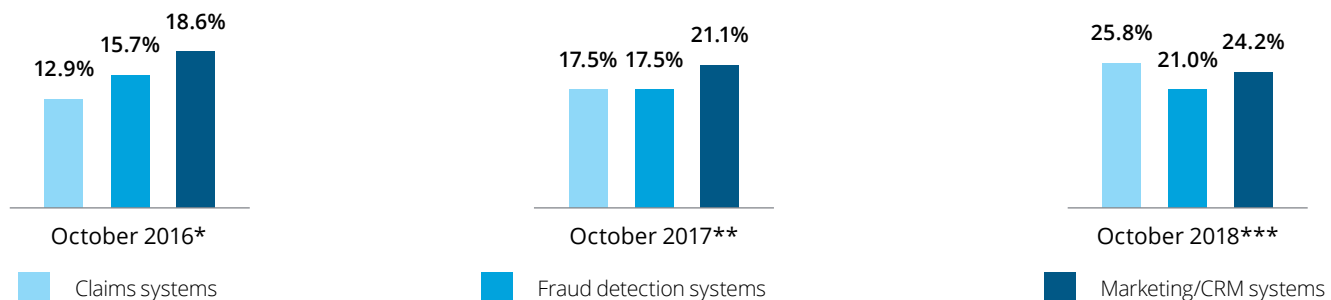
More and more core business capabilities are likely to move into the cloud as carriers continue to pursue legacy system modernization. Survey data from Ovum, a technology research firm, measured the progress of Software as a Service (SaaS)—much of it residing in the cloud. Ovum's data suggest that insurers are already leveraging cloud applications for core operational activities, although there is still plenty of room for growth here. For example, the number of US insurers with claims systems fully deployed in the cloud has seen a steady rise from 13 percent in Ovum's 2016 survey to 26 percent in 2018 (see figure 3).²²

Given these trends, technology vendors are likely to increasingly direct their investments to develop innovative cloud-based alternatives, which should spur more insurers to look to the cloud first when replacing on-site legacy systems and adding new functionality, such as artificial intelligence.

These drivers should result in more carriers shifting core system capabilities to the cloud in a bigger way, even as they start opting for a cloud-first strategy for new applications and workloads.

Figure 3. Core insurance solutions fully deployed externally on the rise

Percentage of US insurance respondents with core functional systems fully deployed using SaaS



Sources: * ICT Enterprise Insights 2016/17 – Financial Services & Payments: Insurance, Ovum, October 2016.

** ICT Enterprise Insights 2017/18 – Financial Services & Payments: Insurance, Ovum, October 2017.

*** ICT Enterprise Insights 2018/19 – Financial Services & Payments: Insurance, Ovum, September 2018.

(Disclaimer: Figures may not be completely comparable year-over-year due to variation in the composition of survey respondents.)

What should insurers be doing about cloud?

As with any transformation, getting the most out of cloud will likely require planning, management, and upskilling. To maximize benefits, carriers should develop a multiyear cloud strategy, ideally as part of broader efforts to create the digital insurer of the future.

As insurers plan their IT investments, they should give cloud a higher priority when deploying new applications. At the same time, they should utilize the advanced capabilities of cloud to gain access to better analytics for business decisions.²³ For legacy systems, carriers should apply scoring rules based on business value, application complexity, and system criticality to identify which applications to migrate to the cloud and when. The result is a phased cloud migration path based on a carrier's specific requirements.²⁴

As discussed later in the regulatory section of this outlook, cybersecurity seems to be an area of concern for many with cloud, because core systems and critical data are essentially being moved off-site to a third party. Regulators across the United States, Europe, and Asia have begun questioning the risk management implications of cloud migration. Insurers should keep in mind that while it may be true that providers are accountable for the security of their cloud's hardware and software, applying security policies to cloud functions ultimately remains an insurer's responsibility.

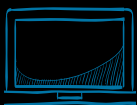
The bottom line in cloud:

Key questions the insurance C-suite should consider



Change the mind-set

Is your organization ready to move core business capabilities into the cloud? Will you opt for cloud-native solutions while migrating legacy systems? Are you starting to adopt cloud when developing new applications? Do you see cloud as a means to gaining access to improved analytics and organizational agility?



Let's get started

Does your cloud strategy include a multiyear, phased migration path? Have you started to plan and upgrade processes and resources to achieve your cloud strategy? Have you identified the applications and workloads to be migrated to the cloud? Can you tap into an ecosystem of service providers to get maximum benefit from cloud adoption? Have you adapted your security policies for cloud use?

Spotlight on blockchain trends

Moving off the drawing board and into full-scale applications

This year has mostly been about assessing where the most immediate value of distributed ledger technology may lie for insurers, determining what processes to upgrade initially, and figuring out how to collaborate with competitors. Looking ahead, 2019 will likely see the industry move past basic education and proofs of concept to preparing for the launch of an increasing number of real-world blockchain applications impacting day-to-day operations.

In Asia, for example, AIA Hong Kong launched a blockchain-enabled bancassurance platform allowing the life insurer and its bank distributors to share policy data and digital documents in real time, streamlining the onboarding process, improving transparency, and reconciling commissions automatically through smart contracts.²⁵ On the property-casualty side, the Hong Kong Federation of Insurers is working to establish a blockchain-based auto insurance platform.²⁶ In Europe, AXA is offering flight-delay insurance over a blockchain platform with parametric triggers and smart contracts.²⁷

In addition, groups of insurers are forming consortiums to share startup expenses as well as enable cross-industry collaboration, open-source agility, and quicker scalability.

While we probably won't see sudden and dramatic implementation growth in 2019, large carriers and consortiums are expected to launch more impactful blockchain initiatives that could change the shape of insurance operations. This could set the stage for much wider blockchain adoption across the industry going into 2020.

The future of work

Adaptation strategies may become more important

Why should talent be high on insurer agendas in 2019?

Insurers seem to be up against a number of obstacles in maintaining, let alone expanding or upgrading, their talent for the digital age. One is simple supply and demand. While about two-thirds of insurers say they plan to increase staff over the next year, many may find this to be problematic given the general unemployment rate of just 3.7 percent and an insurance industry rate less than half that at 1.7 percent.²⁸ The labor market is perhaps the tightest it has been in a decade, particularly when hiring technology, data science, and actuarial talent.²⁹

Meanwhile, robotic process automation and artificial intelligence that can automate manual tasks are rapidly infiltrating the industry, remaking or eliminating jobs that are labor intensive and even some with cognitive requirements. Insurers will likely be challenged to retrain and repurpose workers impacted by tech upgrades to make more productive use of their time and talent.

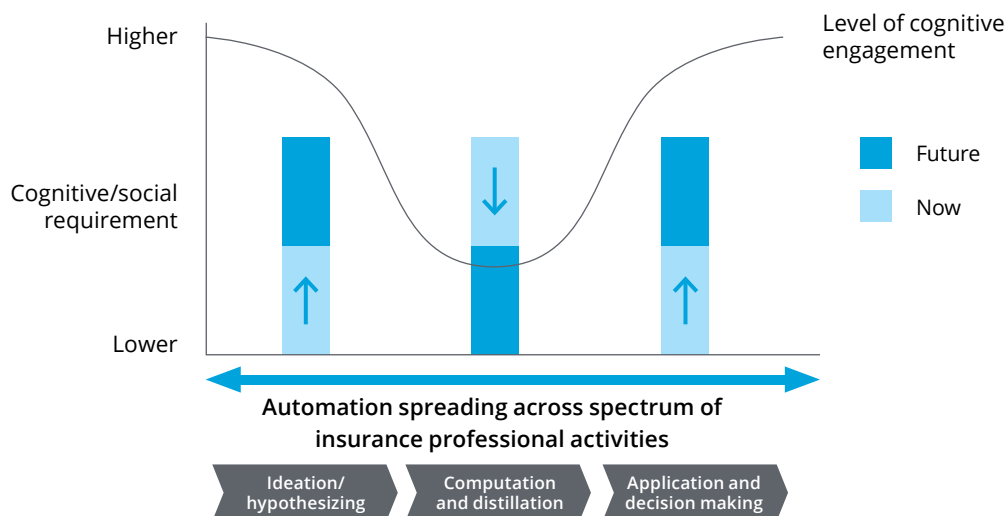
Where is talent heading in the next 12-18 months?

Most insurers are coping with drastic changes in the economy and workforce, calling for more creative and proactive approaches to recruitment, retention, and the very notion of the workplace.

To start, most insurers are decomposing jobs to analyze how work is currently performed, determine which capabilities can and should be automated, and establish what new skill sets may be required to maximize the value employees can bring in the wake of automation. The time and attention of actuaries, underwriters, claims adjusters, and other key players will likely be freed up for higher-level tasks and more strategic responsibilities.³⁰ Employees should ultimately be spending more time on ideation and decision making—and far less on computation and distillation (see figure 4).³¹

Beyond technology, insurers are also putting plans in place to respond to broader, fundamental employment shifts as more professionals join the open talent economy—a blend of full- and part-time workers, short-term contractors, and freelancers. Time is short, as nearly 6 million people, 3.8 percent of workers, held contingent jobs in the United States in May 2018. Another 10.6 million held other alternative work arrangements, including independent contractors, on-call workers, temporary help agency workers, and for-contract firms.³²

Figure 4. Future state of insurance “exponential professional” functions



Source: "The robots are coming: The future of the actuary," Deloitte Consulting LLP LLP, 2015.

What should insurers be doing about talent?

With traditional employee roles and workplace structures in transition, insurers should start transitioning now to the more flexible and virtual workforce of the future. Carriers can set the tone at the top by developing leaders who know how to act, think, and influence in this new working environment, promoting the organization's revamped digital DNA. At a minimum, new job descriptions would have to be written for long-established functions, and additional training could be required to repurpose current and future staff and help them evolve along with emerging systems and technologies. The goal is to create exponential insurance professionals—those augmented by emerging technologies and poised to leave behind traditional tasks to focus on higher value, strategic roles.

The biggest organizational challenge will likely be to constantly adapt and invest in new capabilities so insurers can take advantage of rapidly developing talent opportunities. Integration of cutting-edge technology should help insurers attract younger, more tech-savvy workers into the industry. However, this new workforce will likely demand an exceptional physical and digital workspace, as well as an appealing experience that puts employees at the center, helps them feel engaged, and keeps them in the fold.

While recruitment of new blood is important, insurers should also pay closer attention to retraining and retaining Baby Boomers, who typically have irreplaceable institutional knowledge and industry experience. Cross-mentoring between Baby Boomers and Gen Z employees just entering the workforce could benefit both groups.

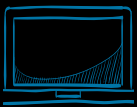
The bottom line in talent:

Key questions the insurance C-suite should consider



Change the mind-set

Is your organization analyzing the changes in employee and management skill sets needed to maximize the value of emerging automation? How might you engage the open talent economy to capitalize on the need for flexible staffing and work environments?



Let's get started

Are you developing leaders who can guide an evolving workforce to take full advantage of a digital organization? Does your talent strategy include the capability for ongoing adaptation? What is your plan to attract and retain younger, tech-savvy employees as well as retain experienced Baby Boomers? Are you considering tax, health care, regulatory, pension, and immigration reform to maximize the cost-benefit equation?

Product development trends

IoT, InsurTech can enable more flexible policies

Why should product development be high on insurer agendas in 2019?

Most insurers have long struggled with innovative product development. Working with constraining regulatory oversight, siloed business lines, legacy technology, and long-established processes and culture, how can agility and time-to-market be improved to remain competitive and differentiate in an increasingly fluid society and marketplace? This challenge will likely be exacerbated by rapid, fundamental changes in society, the economy, and technology. The sharing and gig economies could fuel rising expectations for an enhanced customer experience based on convenience and customization, while blurring the boundaries of commercial and personal insurance lines as well as undermining the relevance of many standard coverages.

These disruptions are prompting demand for hybrid coverages encompassing malpractice, product, auto, and cyber liability policies, as well as for entirely new product lines altogether.

Where is product development heading in the next 12–18 months?

Insurers should modernize and personalize policies, with swifter rollouts and more meaningful tracking of trends and results. One-quarter of those operating in the sharing economy, who believe there is a risk to doing so, said they want coverage they can activate or deactivate as needed. About 22 percent indicated they were interested in being automatically insured when buying/renting services or possessions to manage this risk.³³

Consumers increasingly want more control over their specific coverage. A survey of life insurance consumers indicated that 90 percent of buyers revealed a preference for self-management of existing policies through digital channels.³⁴ One example might be “pay as you ride” supplemental life insurance coverage for motorcycle enthusiasts. Such a feature could even be embedded into the product in the vehicle sale process.

Several InsurTechs are already engaging in real-time, as-needed coverage. Trōv, a global on-demand insurance agency, uses an application that enables consumers to insure single items such as cameras and digital devices with coverage that can be activated and terminated at any time over a mobile app.³⁵

Incumbents can often speed up product development by simply backing or acquiring a developing InsurTech innovator. With investment from Munich Re, among others, InsurTech company Bought by Many created a way for customers to sidestep traditional routes to purchase niche products that legacy insurers often avoid, such as travel insurance for those with preexisting medical conditions.³⁶ Liberty Mutual provided backing for startup REIN, a platform offering customized coverage for the new drone market.³⁷

What should insurers be doing about product development?

More insurers might consider accelerating product development by backing InsurTechs offering new, more relevant coverages, capabilities, and platforms, unburdened by the usual policy categories or annual commitments.³⁸ InsurTechs tend to be less encumbered by legacy issues facing incumbents yet could benefit from the brand, experience, and capital provided by incumbent partners already established in the marketplace.³⁹

Personal lines have attracted the lion's share of InsurTech activity, but more applications are expected to target underdeveloped areas, particularly the small-to-middle commercial markets as well as life insurance, perhaps leveraging the innovations in sensors, analytics, and distribution already deployed in auto and homeowner's insurance for other sectors.

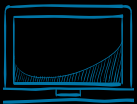
However, while sensor-based telematics policies are poised to become a major force in product development, such programs may yet end up being a major challenge for insurers to implement and market. About one-third of CIOs at insurers surveyed by Ovum said their biggest challenge with IoT is the cost and complexity of implementation. About 25 percent cited lack of consumer demand for products incorporating IoT, while just over 20 percent said associated compliance issues, particularly around privacy, were too complex.⁴⁰

The bottom line in product development: Key questions the insurance C-suite should consider



Change the mind-set

Will your organization respond to emerging consumer desires for increased personalization and flexibility of insurance policies and services? Are you considering knocking down traditional product line silos to adapt to a changing economy? Is real-time, consumer-activated insurance a potential capability for your company in the near term?



Let's get started

How will your company alter your policies and distribution system to meet evolving consumer needs and preferences? Will you consider aligning with InsurTechs to introduce new approaches, platforms, and policy designs? Are you effectively bolstering your IoT and sensor-based strategies to modernize current product development programs?

Merger and acquisition trends

Insurers getting mixed signals

Why should M&A be high on insurer agendas in 2019?

Two massive acquisitions in 2018 seemed to set the stage for acceleration in large-deal M&A activity for the insurance industry, but stakeholders appear to have since pumped the brakes. While smaller transactions continued through August, they did not come close to the size and scope of AIG's and AXA's mid-2018 purchases of Validus for \$5.5 billion and XL Group for \$15.3 billion, respectively (see figure 5).

Value-size deceleration notwithstanding, the confluence of unrelenting market pressure to achieve sustainable growth, a lingering abundance of capital and capacity, improving global economies, and an upturn in interest rates may indicate that insurers should be prepared for a potential uptick in M&A in 2019. Still, rising interest rates could be a double-edged sword, because it makes debt more expensive. In the meantime, relatively rich valuations may yet discourage activity in the near term.

Figure 5. Insurance sector M&A activity, 2017–2018

Number of deals	CY 2017 ¹	YTD 2017 ²	YTD 2018 ³	YoY change (Jan. to July)
Underwriters	84	42	45	7%
L&H	31	16	15 ⁴	- 6%
P&C	53	26	30	15%
Brokers	537	315	273	- 13%
Total	621	357	318	- 11%
Aggregate deal value	CY 2017	YTD 2017	YTD 2018	YoY change (Jan. to July)
Underwriters	\$14.8B	\$5.8B	\$28.1B	386%
L&H	\$6.6B	\$2.0B	\$3.7B ⁴	79%
P&C	\$8.2B	\$3.7B	\$24.4B ⁵	553%
Brokers	\$5.4B	\$5.3B ⁶	\$835M	- 84%
Total	\$20.2B	\$11.0B	\$28.9B	162%
Average deal value	CY 2017	YTD 2017	YTD 2018	YoY change (Jan. to July)
Underwriters	\$422M	\$361M	\$2.0B	455%
L&H	\$505M	\$341M	\$610M ⁴	79%
P&C	\$372M	\$374M	\$3.1B	717%
Brokers	\$194M	\$250M	\$104M	- 58%

Source: Deloitte Center for Financial Services analysis using SNL Financial M&A database.

1. CY 2017 represents full calendar year 2017.

2. YTD 2017 is defined as January 1 to July 31, 2017.

3. YTD 2018 is defined as January 1 to July 31, 2018.

4. Includes Lincoln/Liberty Life Assurance Company of Boston transaction (deal value: \$2.8B).

5. Includes AIG/Validus transaction (deal value: \$5.5B) and AXA/XL transaction (deal value: \$15.4B).

6. Includes KKR/USI transaction (deal value: \$4.3B).

Where is M&A heading in the next 12-18 months?

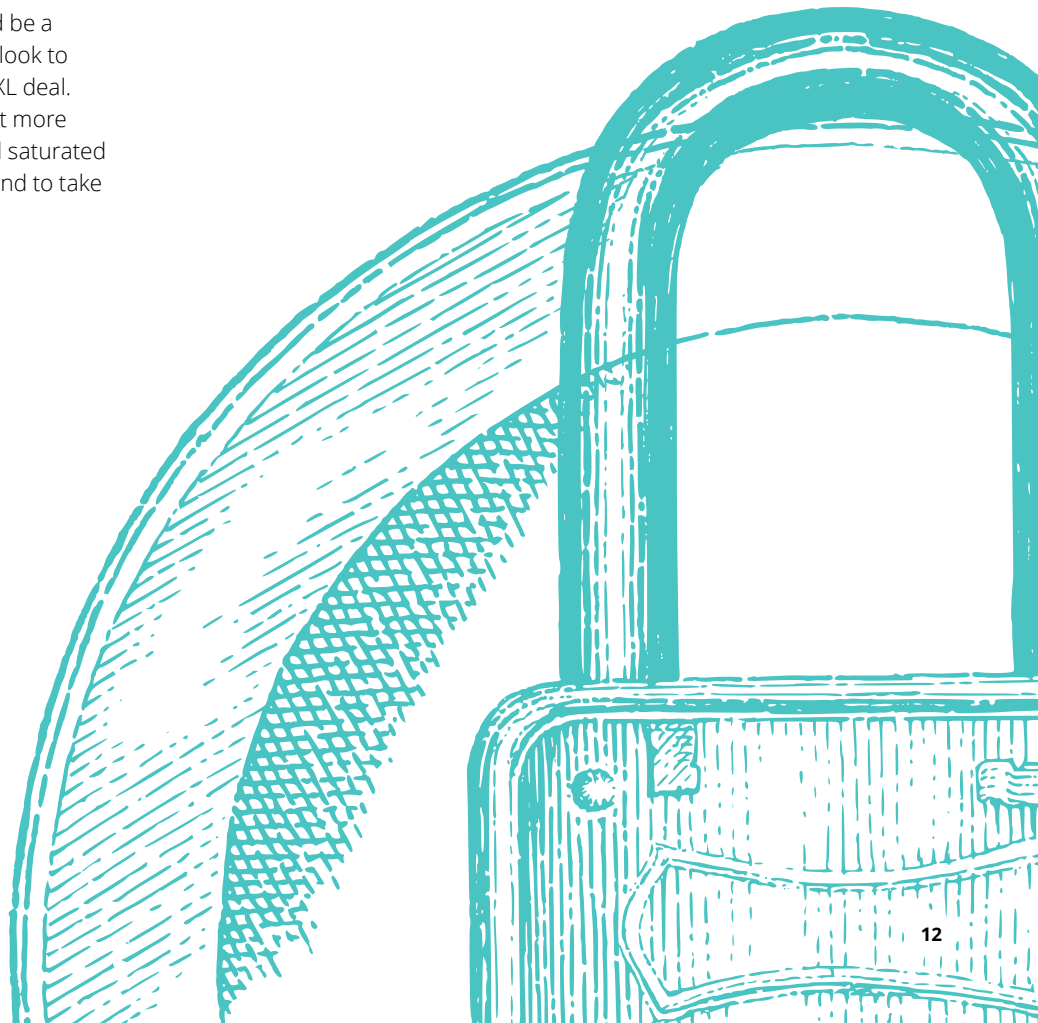
Continued soft rates could drive larger property-casualty acquisitions to increase market share, diversification, and growth in niche areas. The Hartford Financial Services Group announced a bid for Navigators on August 22, 2018, to enhance product offerings, geographic reach, and specialty lines capabilities.⁴¹

Life insurance and annuities companies may see more financial rather than strategic investors, as rising interest rates make them increasingly attractive assets. Through November 2018, investor consortiums purchased The Hartford Financial Services Group's life and annuity unit (Talcott Resolution),⁴² as well as Voya Financial's closed block variable annuity and fixed indexed annuities.⁴³

Foreign interest in the US insurance market could be a further catalyst. More European companies may look to grow their US presence on the heels of the AXA/XL deal. However, relatively high market valuations make it more likely Japanese players seeking to expand beyond saturated local markets will dominate, as they historically tend to take a longer view in return models.

Private equity groups in particular appear to be bullish on insurance entities, especially those with a sizable asset base, such as annuities providers.

Middle-market companies (those between \$500 million and \$2 billion) may consider consolidation to grow and build out their portfolio capabilities, particularly mutual insurers. In addition to lack of size, scale, and breadth of capabilities, mutual structures often do not allow full access to capital on their balance sheets. In May 2018, two mutual holding companies—The Main Street America Group and American Family Insurance—announced plans to merge to diversify their products and policyholder base.⁴⁴



What should insurers be doing about M&A?

Carriers, whether already active or considering entering the M&A arena, should establish their strategy based on aspirations for growth, distribution, and product mix modernization, as well as geographic diversification, then set their targets accordingly. Insurers should also consider proactively reaching out to potential M&A candidates to let them know of their potential interest before others seize the moment. Newcomers to the acquisition market may also need to examine and potentially enhance their in-house strategic and tactical capabilities for efficient and successful transactions.

Players focused on facilitating operational and cultural transformation to enable new digital capabilities should consider InsurTech investments to import a more innovative culture and approach. While some may partner with or invest in these entities, others will likely purchase them outright to acquire skill sets and technology platforms, as well as product and distribution enhancement or diversification to heighten customer experience or improve efficiency. There should be more InsurTechs on the market, as private equity and venture capital investors seek to liquidate maturing InsurTech investments and as InsurTechs look to consolidate to eliminate competition and add capabilities.⁴⁵

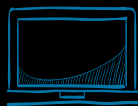
The bottom line in M&A:

Key questions the insurance C-suite should consider



Change the mind-set

Will an acquisition drive growth for your company in the absence of organic options? Are you considering targets “outside the box”—including considerations such as alternative geographies, business lines, and technology providers?



Let’s get started

Does your company’s growth strategy align effectively with potential acquisition targets? Are your current M&A capabilities robust enough to engage in efficient and successful transactions? What about InsurTech opportunities—are your operations agile enough to absorb an InsurTech target without diluting its inherent value as an entrepreneurial disruptor?

Regulatory trends

Focus broadens from solvency to market conduct

Why should regulation be high on insurer agendas in 2019?

Insurance regulators around the globe are broadening their focus from solvency to include market conduct oversight as macroprudential regulation (developed in the wake of the last financial crisis and aimed at reducing systemic risk) nears final adoption.

In the United Kingdom, for example, the Financial Conduct Authority is researching “consumer needs, attitudes and behavior to set out an overarching strategy—Our Future Approach to Consumers.”⁴⁶ In addition, the International Association of Insurance Supervisors (IAIS) has said market conduct will be a focus of its upcoming five-year strategic plan.

In the United States, the Department of Labor’s fiduciary rule for investment products fell under that market conduct umbrella. While a court’s vacating of that rule⁴⁷ has provided some breathing room for those offering annuities in the United States for retirement security, the likelihood of state attention makes stricter sales standards seem inevitable.

Where is regulation heading in the next 12–18 months?

There seems little doubt there will be a rule governing sales of US annuity products. However, insurers don’t yet know whether regulation will come at the federal or state level (or both), let alone how strong or limited the rule will be.

The US Securities and Exchange Commission has proposed a rule under which “a broker-dealer would be required to act in the best interest of a retail customer.” This “best interest” standard seems common to state efforts to create a new rule, including those by the National Association of Insurance Commissioners (NAIC) and New York State regulators.

New York provides for a best interest standard of care for all sales of not only annuity products, but life insurance as well.⁴⁸ While the NAIC has declined to add life insurance to its annuity sales standard development for now, it has agreed to consider such an expansion.

What should insurers be doing about market conduct regulation?

What happens if some US state regulators choose to restrict their rule to annuity sales while others do not? Insurers doing business across state lines may have to consider whether they are at a competitive disadvantage compared to single-state carriers. Others may have to evaluate the reputational risk they face by not complying with the highest standards.

In the meantime, product innovations should continue to be aimed at bolstering the utility and value of annuities. Many mutual funds that compete with annuity providers have introduced no-fee equity funds, allowing investors to reap returns without management fees⁴⁹ at a time when greater disclosure of annuity producer compensation is likely. Possible responses may include an increase in combination products including death or long-term care benefits, as well as simpler products directed at younger consumers with low take-up rates.⁵⁰

Ultimately, insurers may need to take more control over the sales process. New York's regulation requires "insurers to establish standards and procedures to supervise recommendations by agents and brokers to consumers." To meet this mandate, insurers may have to review and adjust their compliance structures. At the same time, to enable continuous oversight and management of the sales process, many insurers may increasingly look to adopt the use of regtech enhancements—that is, emerging technologies customized to ease carrier compliance with regulatory mandates, as well as boost oversight capabilities for the regulators themselves.

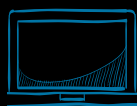
The bottom line in regulation:

Key questions the insurance C-suite should consider



Change the mind-set

Is your company positioned to comply nimbly and efficiently with changing levels and areas of focus for regulatory oversight in areas such as market conduct, cyber risk management, and privacy?



Let's get started

Has your organization considered how it will respond if regulatory standards for acceptable producer behavior change and perhaps differ? Are you reviewing your product design and mix to minimize compliance and competitiveness concerns? Have you examined adopting regtech to better enable ongoing oversight of the sales process and other compliance challenges?

Spotlight on sustainability trends

Climate change impact climbing to top of regulatory agenda

Sustainability disclosure and risk management regulations may be the next major issues insurers face. More than 200 global regulator members of the IAIS have identified sustainability as a major emerging issue⁵¹ and a focus of the organization's new five-year strategic plan.

Sustainability exposures the IAIS identified include liability, underwriting, market, investment, strategic, operational, reputational, pricing, and asset risks.

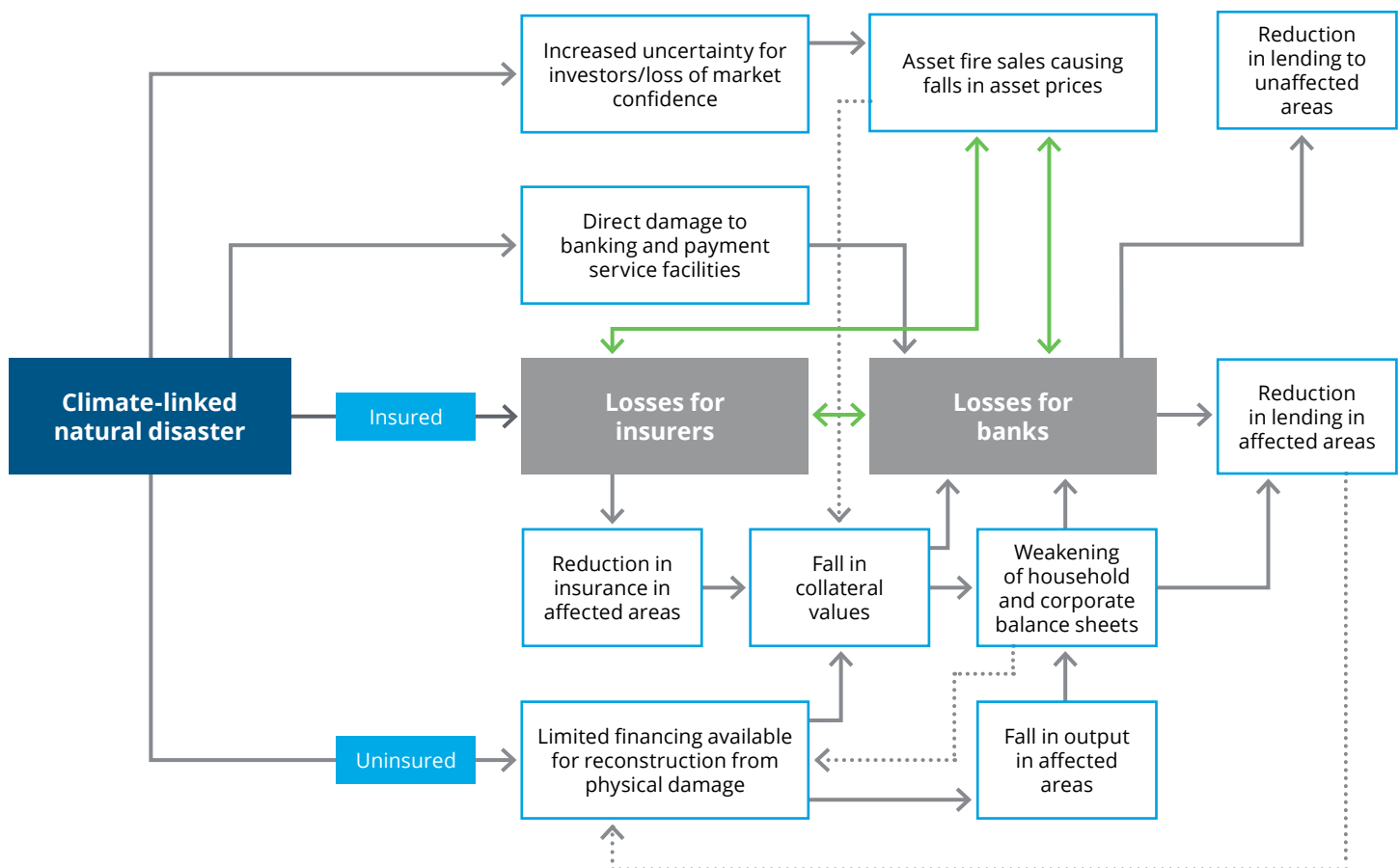
The G-20's Financial Stability Board Task Force on Climate-related Financial Disclosures has issued recommendations, including disclosure of board oversight and of management's role in assessing climate-related risks and opportunities. Regulators are also urging disclosure of climate change assessment metrics and risk management strategies, with some calling for climate change risk reporting to be included in the NAIC's Own Risk and Solvency Assessment.

Disclosure is the core issue for insurers and involves various operational concerns. The task force says, "Disclosure of climate-related financial information is a prerequisite for financial firms not only to manage and price climate risks appropriately but also, if they wish, to take lending, investment or insurance underwriting decisions based on their view of transition scenarios."⁵² All disclosures should be included in a company's public annual financial filings.⁵³

With the task force proposing a five-year time frame for full implementation of its recommendations, insurers may wish to begin by ensuring appropriate goal setting and oversight at the board level, along with creating appropriate metrics for senior management, reflecting that climate risks are or could be material.

As climate change may be tied to the rise in frequency and severity of natural disasters, this appears to be a core issue for insurers, as well as the broader financial sector and economy at large (see figure 6 on the following page).

Figure 6. Tracking natural disasters to financial sector losses, macroeconomic impact



Source: Sandra Batten, Rhiannon Sowerbutts, and Misa Tanaka, "Let's talk about the weather: The impact of climate change on central banks," Bank of England Staff Working Paper No. 603, May 20, 2016.

Cyber risk trends

Regulations expanding globally

Why should cyber risk be high on insurer agendas in 2019?

In early 2018, one think tank estimated that cybercrime costs the global economy the equivalent of 0.8 percent of GDP, or \$600 billion annually.⁵⁴ The financial sector—where the money is—may be particularly vulnerable.

Regulators around the world have moved quickly to create cyber risk management standards. The IAIS was scheduled to consider a revised application paper on cyber risk at its November 2018 annual general meeting, as this outlook was being published. The paper is based on the G7's "Fundamental Elements of Cyber Security for the Financial Sector."

Some insurers operating in the United States—especially the almost 2,000 regulated insurance entities in New York⁵⁵—may have already made progress toward compliance with existing and proposed cyber regulations. This is primarily due to having to comply with the first-in-the-nation New York State Department of Financial Services (NYDFS) cybersecurity regulation, which is now nearly in full effect. The NAIC adopted cyber regulations based on those promulgated by NYDFS, enabling those compliant with that standard to be deemed compliant with the NAIC model.

Where is cyber risk regulation heading in the next 12–18 months?

As the NAIC model makes its way through various state legislatures, the final transitional period for compliance with the New York regulation will end in March 2019. Except for the few exempted insurers, as of September 2018, all operating in New York should be compliant with most requirements, including having cybersecurity policies and programs in place, performing training and testing, appointing a chief information security officer or the equivalent, and other essentials. Managing the cyber risk associated with third-party providers is the last requirement to be phased in, effective in March.

Insurers operating in New York that do not already have all these pieces in place risk penalties from the regulator. Those not directly affected by the New York regulation should by now have made substantial progress toward compliance, given the expected nationwide adoption of the similar NAIC model.

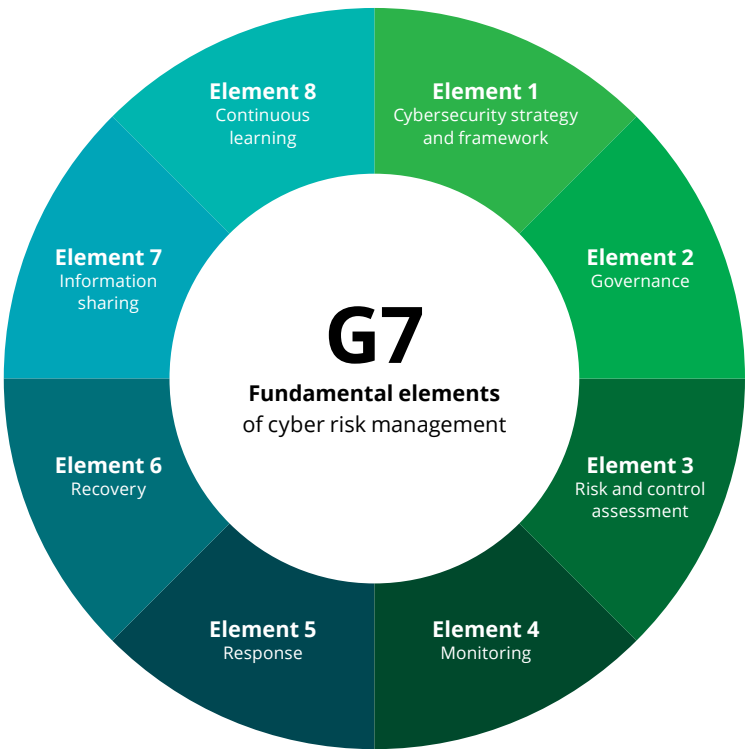
What should insurers be doing about cyber risk regulation?

Even as regulations aiming to reduce the more obvious cyber risks go into effect, insurers may wish to begin preparing now for increased worldwide regulatory oversight (see figure 7), including of third party risk management which is, as noted above, the final phase of the New York regulation to become effective.

According to the Bank for International Settlements (BIS), "Risks stemming from outsourcing core function...seem not insignificant."⁵⁶ Third party cyber risks to be managed include data security (including cyber), data location and access, and integrity of information systems.

A recent BIS survey of jurisdictions worldwide shows such oversight tends to focus on a materiality assessment; risk assessment of data security, confidentiality, and availability; rights of information and audit; the reversibility of service; business continuity and exit plans; offshoring and subcontracting; and robust legal arrangements. Insurers not yet subject to such oversight might take the time to prepare.

Figure 7. Cyber risk management attracts global regulatory interest



The G7 developed the "Fundamental Elements of Cybersecurity for the Financial Sector" to help bolster the overall cybersecurity and resiliency of the international financial system.

Source: IAIS Update: 2018 Global Seminar, September 2018.

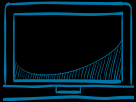
The bottom line in cyber risk management:

Key questions the insurance C-suite should consider



Change the mind-set

Are you managing your cyber risk in a way that enables secure innovation? Is your organization embedding security early on for digital investments and moves to the cloud? Does cybersecurity permeate every level of the company?



Let's get started

Do you know where all your data are and what risks attach to that? Is your organization prepared to properly manage third-party cybersecurity risks, including cloud adoption and concentration exposures? Do you have business continuity and exit plans in place for your third-party provider relationships?



Spotlight on cyber risk insurance trends

Fundamental obstacles continue to hinder market's growth

For the most part, cyber insurance has yet to live up to expectations of being perhaps the biggest organic growth opportunity for property-casualty insurers. US cyber insurers generated only \$1.84 billion in premiums in 2017—although that represents a 37 percent increase from the prior year, with most of the gains coming from package business, where volume nearly doubled.⁵⁷ However, even with those hefty increases, global premiums are estimated by various sources to have only risen to between \$3.5 billion and \$4 billion, meaning cyber remains a niche market that has yet to mature for sellers and buyers alike.

Over the past few years, some predicted that cyber insurance could grow exponentially into the \$20 billion to \$25 billion range by the early 2020s. More recently, Munich Re estimated that the market may double to more than \$8 billion by 2020,⁵⁸ but even that more modest forecast could be difficult to achieve. A recent survey by the Council of Insurance Agents and Brokers found that only one-third of the respondents' clients had purchased cyber coverage, which was the same as six months earlier, with policy limits averaging just \$3.2 million—a proverbial drop in the bucket if a major event occurs.⁵⁹

Insurers are likely writing cyber risk with extreme caution because of the unmet challenge in modeling a moving target, as new threat actors and types of attacks keep emerging. It is also a difficult coverage to mass market because while vulnerabilities may be common, the risks are often individualized to each industry and buyer. There may be hesitance as well because data-rich insurers themselves are prime targets.

As insurers continue to refine their cyber coverages and work on underwriting and pricing this emerging risk, carriers should reexamine existing property and liability policies for “silent” cyber coverage they didn't intend to write, working with brokers and clients to make coverage explicit through clear revisions of terms and conditions, additional endorsements, and/or introducing supplemental, stand-alone policies. Directors and officers liability is one example of a standard coverage that could face new and perhaps unanticipated exposures for companies experiencing a cyber breach.

Privacy trends

New rules put insurers in the hot seat

Why should privacy be high on insurer agendas in 2019?

Consumer privacy is an emerging global issue for which insurers need to be prepared or risk suffering serious consequences.

According to the European Union Charter, all EU citizens have the right to protection of their personal data. The European Union's General Data Protection Regulation (GDPR) may seem to go a little further, applying extraterritorially to "all natural persons, whatever their nationality or place of residence, in relation to the processing of their personal data,"⁶⁰ and all companies doing business in the European Union. This could be read to mean that not just EU residents but also anyone physically in the European Union at the time of a transaction are covered by the law.

In the United States, California adopted a similar law in June 2018—the California Consumer Privacy Act of 2018.⁶¹ Consumer rights specifically enumerated in the law include various disclosure rights and the option to remove personal data permanently from public access.

Where is privacy regulation heading in the next 12–18 months?

GDPR went into effect in May 2018 and requires consent from consumers before their data may be used.⁶² Among numerous protections, consumers will need to be informed if their data is moved outside the European Union, have the right to be "forgotten," and will be given a chance to contest the use of automated algorithms.⁶³

Violations come with serious fines—up to 4 percent of a company's worldwide net sales.⁶⁴ Insurers doing business in the European Union or with people residing in the European Union should already have appointed the required data protection officer.⁶⁵

The California law is effective on January 1, 2020.⁶⁶ In general, it gives covered companies 30 days to cure an alleged violation, and if that's not done, the law allows consumers to pursue a private right of action in certain circumstances and enables the state's attorney general to pursue civil penalties.⁶⁷

What should insurers be doing about privacy?

Those affected by GDPR need to make sure their compliance plans are in place and are being effectively executed. This is equally true for those in jurisdictions outside Europe that are considering or adopting similar privacy rules, such as California.

Executive sponsorship could be key as insurers adapt to the new privacy environment. Compliance requires involvement of just about all the stakeholders in an organization, not just legal and IT. In the long run, insurers should work to ensure their operating models address and respect a broader definition of privacy and the management of privacy risk than whatever may have been standard previously.

Despite these compliance concerns, insurers should be thinking about how they could capitalize on the enormous amounts of new types of data they are collecting via telematics sensors, social media, and other new sources. How might the rapidly expanding universe of alternative data be productively and profitably harvested for the mutual benefit of insurers and their policyholders alike, without running afoul of any regulatory restrictions? The answers to those questions could be differentiators.

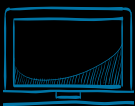
The bottom line in privacy:

Key questions the insurance C-suite should consider



Change the mind-set

Are you considering the effect on your operating model if the data you have is no longer wholly yours?
Are you prepared or preparing to cope with increased consumers' rights to their data?



Let's get started

Are you taking an enterprise-wide approach to compliance with new privacy regulations where they impact your firm? Is it being driven from the top? Even if not directly affected by new laws, are you planning to address consumer privacy concerns? Given the spotlight on sharing and using customer data, is your firm positioned to successfully capitalize on the full value of the growing number of sources and volume of information while satisfying regulatory concerns?

Spotlight on accounting rule changes

Many insurers lack confidence they will be ready in time

Significant changes are coming to insurance accounting. The International Financial Reporting Standards No. 17 (IFRS 17), *Insurance Contracts*, was issued in 2017 and will be effective in most countries on January 1, 2021. At the same time, US GAAP is undergoing changes as the Financial Accounting Standards Board (FASB) recently issued ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts*.

IFRS 17 is designed to enable consistent, principles-based accounting for insurance contracts. The new standard requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts.

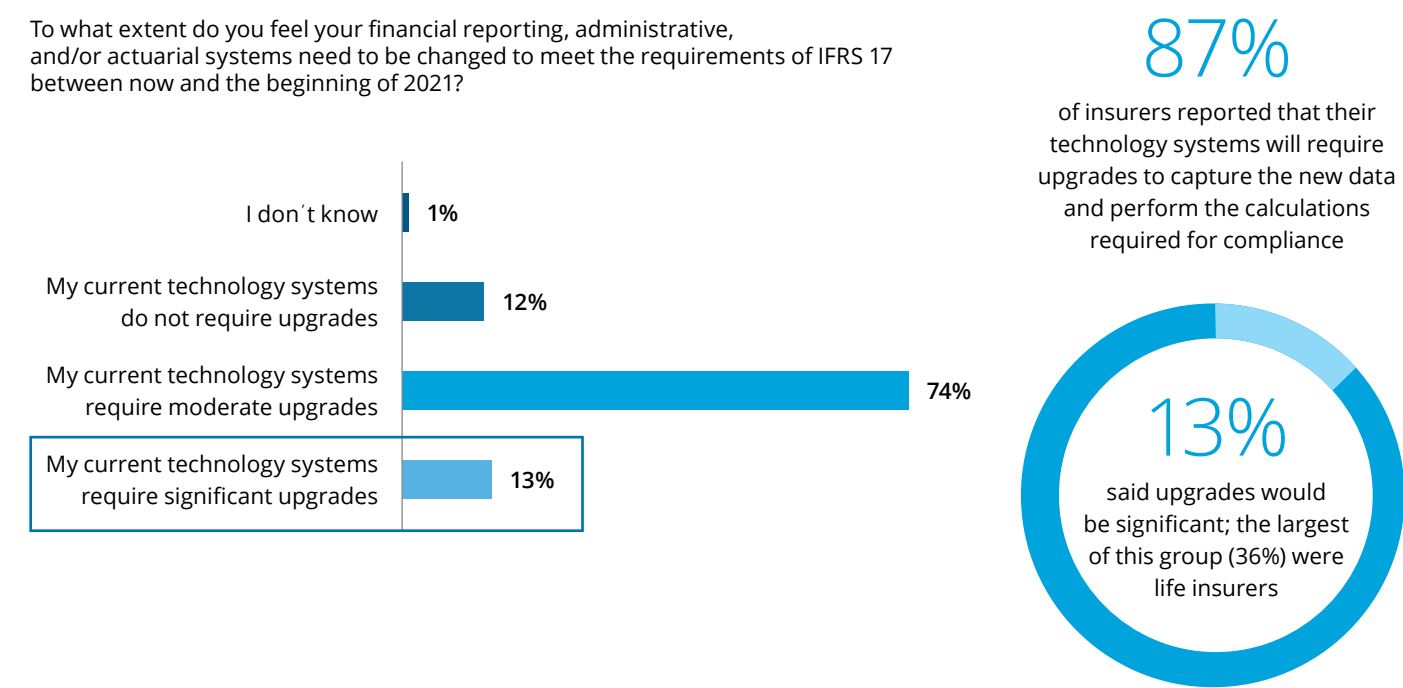
For insurers subject to US GAAP, ASU 2018-12 is a significant change that takes effect on a similar timeline to IFRS 17. The ASU is effective for fiscal years beginning after December 15, 2020, for public business entities, and for fiscal years beginning after December 15, 2021, for all others.

ASU 2018-12 is meant to improve certain aspects of financial reporting related to long-duration insurance contracts, including the measurement of liability for future policy benefits related to nonparticipating traditional and limited-payment contracts; the measurement and presentation of market risk benefits; the amortization of deferred acquisition costs (DAC); and presentation and disclosures.

In a recent Deloitte global survey of 340 insurers of different types, sizes, and geographic regions (see figures 8 and 9)—with results cited in “2021 countdown underway: Insurers prepare for IFRS 17 implementation”—only 37 percent of life insurers indicated they had strong confidence they would be ready for IFRS 17.⁶⁸ So, most need to get going and ramp up their compliance efforts if they expect to catch up in time.

Leadership involvement and awareness as well as an effective education program form the foundation for proactive implementation. Insurers may also wish to review the suitability of their information systems. In the Deloitte global survey, 87 percent of insurers believed their system technology would require upgrades to capture the data necessary for IFRS 17.⁶⁹

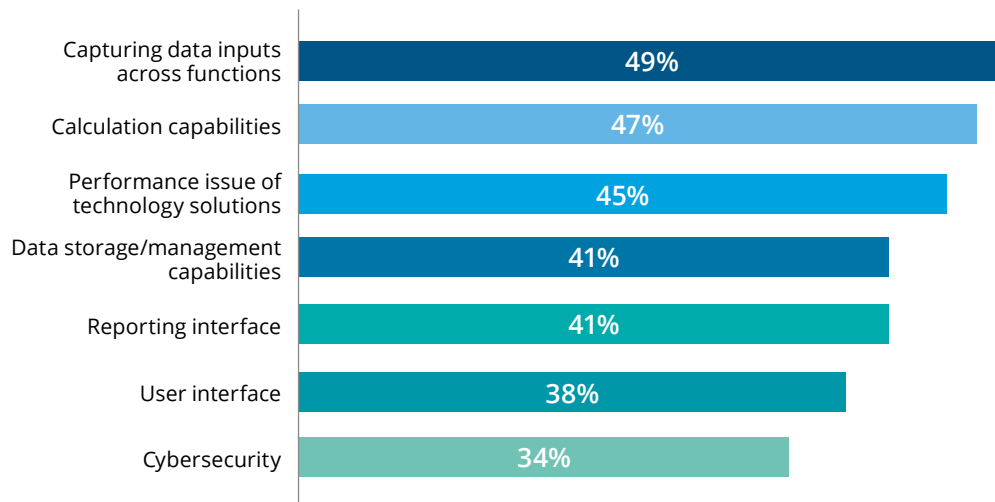
Figure 8. Global IFRS Insurance Survey 2018 finds most insurers need technology upgrades for IFRS 17 compliance



Source: "2021 countdown underway: Insurers prepare for IFRS 17 implementation," Deloitte 2018.

Figure 9. Survey finds varied technology challenges to IFRS 17 compliance

Which aspects are you struggling with in preparing your technology solutions to support IFRS 17 compliance?



Source: "2021 countdown underway: Insurers prepare for IFRS 17 implementation," Deloitte 2018.

Tax reform

Early results positive, but long-term impact uncertain

Why should tax reform be high on insurer agendas in 2019?

A recent Organisation for Economic Co-operation and Development (OECD) report cited significant tax reform packages enacted in Argentina, France, Latvia, and the United States, with other countries introducing more piecemeal reforms. The global trend has been to lower corporate income tax rates, with the average in OECD countries dropping 8.6 percent since 2000.⁷⁰

Insurers doing business in the United States are still adapting to the changes introduced in the Tax Cuts and Jobs Act of 2017 (2017 Tax Act). The US Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) have not yet issued guidance on certain important, newly enacted provisions, including how the new loss carryover rules will fit with the old rules in the context of life-nonlife consolidated returns, as well as application of the base erosion and anti-abuse tax (BEAT) to reinsurance. Insurers will therefore have to interpret and apply the law to the best of their ability pending such guidance.

Where is tax reform heading in the next 12–18 months?

The impact of tax reform is expected to vary significantly across insurers depending on a company's profile. For starters, the international tax landscape has been reworked. An area where there has been guidance is the one-time "transition tax" on the accumulated earnings of US insurers' foreign subsidiaries. Treasury concluded that US insurers will have to include such earnings in their foreign subsidiaries based on the higher "cash" tax rate—that is, 15.5 percent—when calculating the transition tax owed. Insurers had argued that their assets were operating assets and should be taxed at the lower rate available to other industries—8 percent—for such assets.

Yet for profitable US insurers, tax reform has been largely positive to earnings. For US-headquartered multinational insurers, the results are also generally positive. For example, midyear 2018 reports for US P&C insurers and reinsurers show a drop in their overall effective tax rate from 24.5 percent in 2017 to 17.4 percent.⁷¹

However, these insurers have some risk of increased taxes related to their non-US earnings, which may no longer be deferred due to the global intangible low-tax income (GILTI) provision in newly enacted section 951A. GILTI subjects non-US earnings to a minimum tax and could cause significant issues if an insurer has losses or is subject to non-US tax credit limitations. Further, US-based insurers have some risk of increased taxes to the extent the government decides that outbound claims payments (and possibly other payments) on reinsurance contracts are subject to BEAT in newly enacted section 59A.

Insurers headquartered in non-US jurisdictions may be negatively impacted by the BEAT if they cede US risk to foreign affiliates, because deductions in the United States for premiums paid to non-US affiliates would be denied. Treasury and the IRS have some significant open issues to address with respect to BEAT and GILTI as they pertain to insurers. However, the extent to which this guidance will incorporate any insurance industry-specific details, such as the definition of deductible reinsurance premium payments for BEAT purposes, is unknown.

What should insurers be doing about tax reform?

The taxation of international operations has become more complex in the wake of the 2017 Tax Act. It is therefore important for insurers to make the appropriate investment of resources to model out and understand their specific tax profiles year over year as well as on a forward-looking basis. Armed with such precise information, companies can best position themselves to develop and implement plans to mitigate potential tax increases or “uneconomically based” taxation results.

To combat excessive GILTI, examining projections and planning taxable income will be required. Taxpayers that are subject to the BEAT should examine their reinsurance agreements and payments to non-US affiliates and make adjustments to these arrangements if possible.

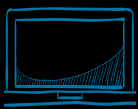
The bottom line in tax reform:

Key questions the insurance C-suite should consider



Change the mind-set

As new guidance is issued, forward planning and evaluation of tax operating models may help insurers maximize their returns. Are you challenging the status quo in light of the new realities?



Let's get started

Have you appropriately modeled your organization's tax profile to mitigate tax burdens? Is your ERP system tax-enabled? Have you reviewed the tax function's resource model? Have you considered handing off noncore items to outside providers and optimizing your technology use to enable more tax function focus on high-value items? If applicable, have you examined and adjusted reinsurance agreements in line with BEAT?

Where do insurers fit in an evolving economy and society?

Industry needs shift in thinking and approach to stay ahead of the curve

All of the issues raised in this report are important in their own right for insurers to address over the coming year, whether it's the imperative to upgrade technology capabilities for a digital economy, alter the talent infrastructure to accommodate the future of work, comply with the latest regulatory changes, or adapt policies and distribution systems to meet evolving customer needs and preferences.

However, there is a broader, more foundational challenge confronting carriers—the ability to continue changing to keep up with ever-shifting conditions in the economy and society at large. Consider, for example, the blurring of boundaries between lines of business, coverages, and entire industries thanks to the emergence of the gig and sharing economies, with a growing number of insureds working remotely and on a contract basis, while using their personal property for commercial purposes. Then there's the rise of connectivity, which has generated a massive amount of real-time data and turned the insurer's relationship with policyholders from static and transactional to dynamic and interactive. Meanwhile, InsurTech is fundamentally altering the rules of the game and spurring the creation of a new ecosystem driving innovation.

These tectonic shifts have created both threats and opportunities for industry leaders, who may appreciate the impact of digitalization in a broad sense but perhaps not yet see how it will allow them to solve long-standing problems, reduce customer friction, and tap into new profit pools.

Part of the problem could be that insurers still too often hold on to outdated orthodoxies about the industry's inherent ability to ward off fundamental disruption. At a time when InsurTechs are demonstrating the art of the possible, carriers may be depending upon long-standing presumptions about how brand strength, data mastery, capital access, and the complexity of their products insulates the industry from a major shake-up. Such “moats” are unlikely to protect insurers much longer from those who seek to remake the insurance world, which means insurance executives need to change their long-established mind-set and approach to remain relevant and competitive in the long term.

The reality is that winners in the race to become the insurers of the future will likely be those who understand how to change in the way that best suits their particular company and business to create competitive advantage in this new world. And to do that, organizations should change how they think about and execute change.

A key element will likely be agility, determined by an insurer's ability to take advantage of new technology and data sets, design services and solutions rather than products, transform its operating platforms through collaborative initiatives and ecosystems, and do so in a pragmatic and material way. This evolution won't reach fruition overnight, but it is already well underway. The race is on.

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