



2014 Life Insurance and Annuity
Industry Outlook
Transforming for growth
Getting back on track

Contents

Foreword	1
Transformation most likely path to sustain long-term growth	3
Competition and markets: Mergers and acquisitions market may heat up despite headwinds	5
Clients and products: Insurers look to evolve products, mindset to expand growth horizon	7
Governance, risk, and compliance: Regulatory uncertainty over reserving, captive use may leave insurers in the lurch	9
Financial management: Transforming finance to become business partners	11
Organizational effectiveness: People power can make the difference in transformation efforts	13
Technology dynamics: Tech investment can be a critical component of innovation	15
Where should insurers go from here?	17
Contacts and acknowledgements	19

Foreword

Dear colleagues:

"It was the best of times, it was the worst of times. . ." So begins Charles Dickens' *A Tale of Two Cities*. In many ways, this describes pretty well the environment that the financial services industry is facing as we head into 2014. The economy is showing some signs of life, balance sheets are stabilizing, and consumer and manufacturers' confidence indices are trending toward the positive. That said, next year will likely be one of ongoing challenges for industry executives to realign business models, adjust to increasing amounts of regulation, and attempt to innovate for growth.

Insurers' growth prospects will be impacted by the strength and staying power of the economic recovery. Strategic planning by carriers will be affected by marketplace and regulatory uncertainty. The way insurers traditionally conduct their business will be challenged by new competition from both within and perhaps outside the traditional insurance industry.

This doesn't mean insurers don't have the ability to control their own destinies. While constantly reassessing their standard operating procedures, systems, and personnel, they should be prepared to make transformational changes. Innovation may ultimately be the key to keep insurers growing regardless of shifting economic and insurance market conditions, as they devise ways to thwart ongoing and emerging competitive threats as well as capitalize on new opportunities.

We are pleased to share with you this outlook for 2014, based on original research combined with the insights and first-hand experience of many of Deloitte's leading insurance practitioners. The content is organized into six major topical platforms, which are designed to explore both industry-wide competitive and market dynamics, as well as examine tactical trends and opportunities within individual firms, providing insights aligned to the following:

- **Competition and markets** — Evaluates existing industry structure, the competitive landscape, and market composition.
- **Clients and products** — Explores emerging trends in retail and institutional customer behaviors, attitudes, and needs.
- **Governance, risk, and compliance** — Reviews industry risk management practices and regulatory mandates, as well as their potential financial and strategic impacts on industry participants.
- **Financial management** — Highlights how finance leaders can better support their business partners and provide needed insights to their firms.
- **Organizational effectiveness** — Analyzes how firms have responded to talent, process, and other operational challenges.
- **Technology dynamics** — Examines the evolving role of technologies in the industry.

We've included a graphic element, which you'll see throughout the report, that provides a signpost as you navigate the outlook. If you pick up more than one of our financial services outlooks, you'll be able to easily compare how the various industry sectors are addressing the six issues by visiting the corresponding section.

We hope you find this report insightful and informative as you consider your company's strategic decisions in the upcoming year. Please share your feedback or questions with us. We would value the opportunity to discuss the report directly with you and your team.



Gary Shaw
Vice Chairman
U.S. Insurance Leader
Deloitte LLP
+1 973 602 6659
gashaw@deloitte.com

Jim Eckenrode
Executive Director
Deloitte Center for Financial Services
Deloitte Services LP
+1 617 585 4877
jeckenrode@deloitte.com

Transformation most likely path to sustain long-term growth

Insurers adjusting on the fly

Although life insurers and annuity writers might gain some sales traction in the year ahead thanks to modest economic growth, declining unemployment, and the possibility of an uptick in interest rates, many have begun to realize the time may have come to initiate more fundamental changes in their business models to generate sustainable growth over the long term.

Therefore, expect more life and annuity carriers to break out of their historical operating molds over the next couple of years. The goal will be to make more efficient use of capital as well as expand the overall market pie by reaching out to underserved consumer segments in innovative ways.

Some may take the lead and assume the role of pioneers by test marketing simplified products, perhaps through alternative distribution channels. Others might be more comfortable as fast-followers, learning from the example of those on the cutting edge, then tweaking their own transformation initiatives accordingly.

Before too long, however, few may be able to afford to resist this call to arms, which challenges carriers to revamp their standard operating procedures as they adapt to life in a more transparent, self-service-oriented, and mobile-driven marketplace — especially if maintaining the status quo means potentially being left at a competitive disadvantage by bolder players.

“Insurers should embrace an ongoing innovation mindset to keep pace not just with traditional competitors, but to meet potential threats that may soon be posed from players outside the industry,” according to Gary Shaw, U.S. insurance leader at Deloitte LLP. “We anticipate seeing a growing number of carriers reevaluating their business models to compete more effectively regardless of economic conditions, as well as to differentiate their brands as part of the leading edge.”

Going for growth

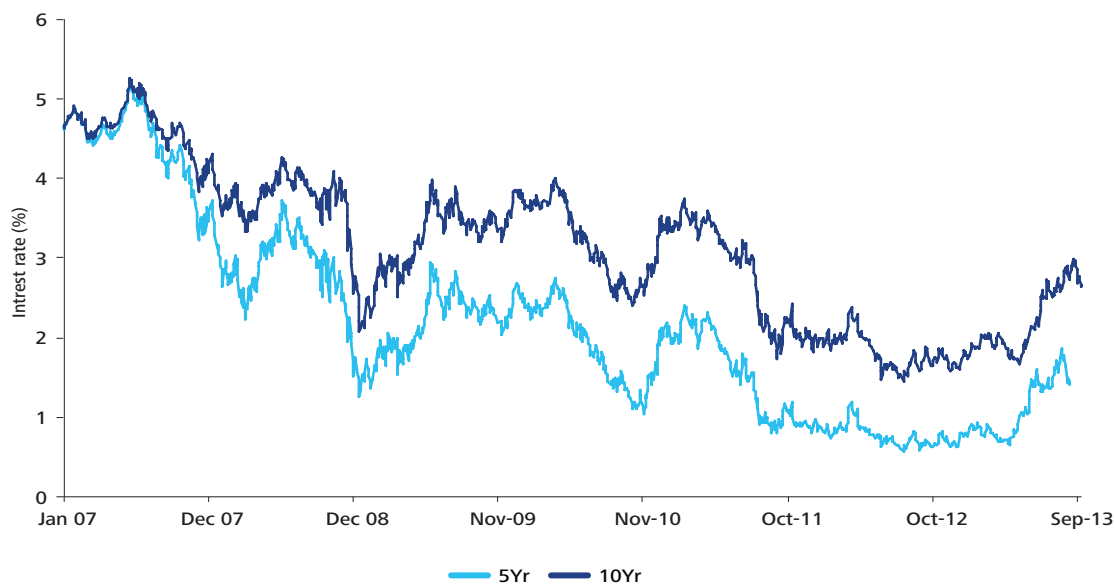
While cost-cutting has been a major goal of many carriers since the financial crisis of 2008, and share buybacks have been a prime option to improve returns to shareholders for a number of publicly-held insurers, growth is reemerging this year as the chief imperative, not merely to bolster bottom lines in the short run, but to assure the industry’s continuing relevance over the long haul. Rather than settling for subtle changes along the edges, we expect to see more carriers shifting into a higher gear by revamping their products, core systems, and distribution options.

Another theme you’ll see throughout this report is that while reshaping how a carrier conducts its operations can make a big difference in revenue and profitability, carriers need the right people and capabilities to propel and maintain momentum for innovation. Indeed, talent transformation could ultimately be one of the most important distinguishing features determining how well carriers perform in this evolving competitive environment.

In the six sections of this outlook, we'll examine a number of the issues keeping insurance executives up at night, scope out how these trends could develop in the year ahead, as well as offer a "bottom line" recap providing suggestions on how insurers might respond.

Figure 1. U.S. Treasury yield curve rate

Persistently low interest rates have undermined both insurer investment returns as well as the profitability of products with guaranteed return features, but the worst is likely behind them as rates are expected to gradually rebound.



Source: US Department of Treasury. "Historical Treasury Rates."
<http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-LongTerm-Rate-Data-Visualization.aspx>. 2013.

Mergers and acquisitions market may heat up despite headwinds



Economic challenges over the past few years have prompted many life insurers and annuity carriers to reassess their strategic priorities. As a result, some have revamped their product portfolios. Others have altered policy features. A few have exited markets entirely.

Yet despite this volatile environment, merger and acquisition activity in 2013 was quieter than many anticipated, for a number of reasons.

For one, a number of publicly-held carriers have been bolstering their share price by allocating excess capital to initiate stock buybacks. However, there are indications that the impact of such a strategy may be playing out, perhaps prompting renewed interest in boosting shareholder value by making an acquisition.

Another factor that has slowed down deal-making in the U.S. market is that potential foreign buyers appear more interested in targeting those doing business in the Asia-Pacific and Latin American regions these days, where they may see greater prospects for growth and profitability. On the flip side, among U.S. carriers there are only a limited set of players that might be interested in or have the ability to pursue a foreign M&A. Indeed, some U.S. players with global footprints may be more likely to consider spinning off non-core foreign books at the moment.

One countervailing trend has been the growing interest of private equity firms in the life insurance and annuity business. Such capital market players see an opportunity to leverage their asset management skills and improve their returns by tapping into a large pool of capital while diversifying their portfolios.

What's new for 2014?

Regulators have expressed concern that private equity firms typically have a shorter-term business model than do traditional carriers, while the life and annuity industry

is designed to provide long-term security for consumers. As a result, heightened government scrutiny has both checked and added a level of uncertainty to the fate of such deals. Some acquisitions have only been approved after regulators have secured enhanced safeguards, such as higher capital standards, greater regulatory oversight of investments, and the establishment of special trust accounts.

One critical question going forward is whether these capital market buyers may reconsider their recent attraction to the annuities industry given these additional regulatory requirements, perhaps taking some momentum out of an already quieter than expected M&A market.

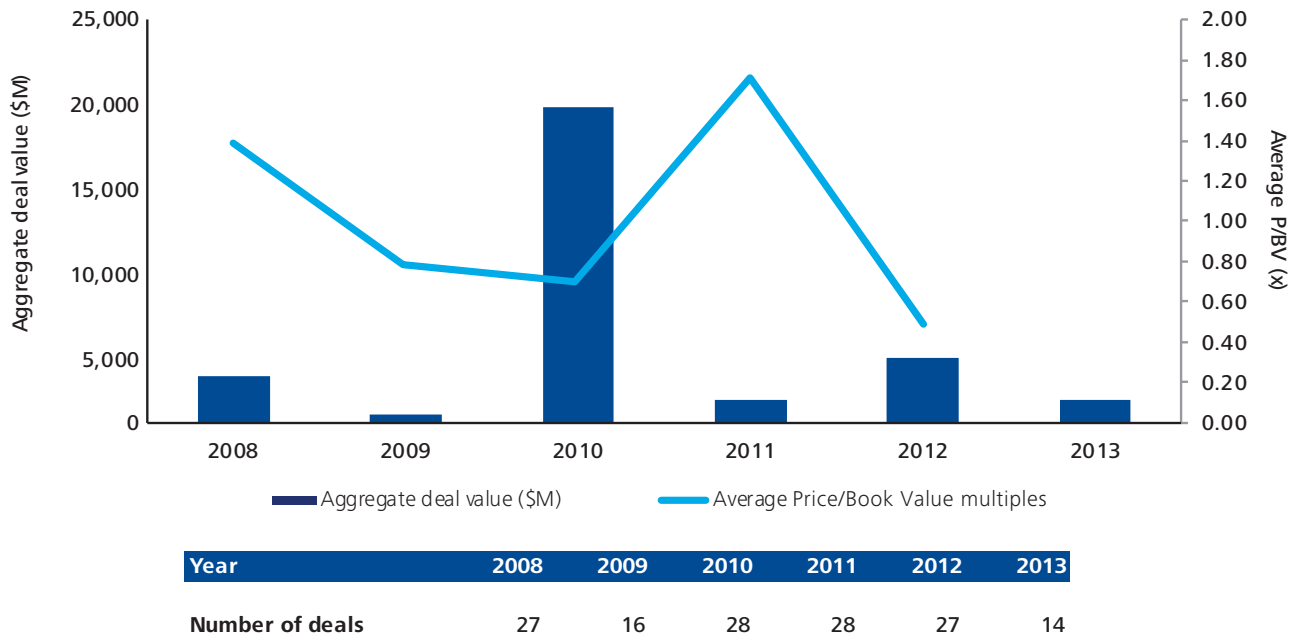
There is also concern that possible increases in risk-based capital requirements under various regulatory reform initiatives could reduce excess capital and take some of the purchasing firepower out of the market. However, at least in the short term, more properties may become available if these changes in capital regulations prompt smaller and mid-size carriers to seek a merger or sale.

From the seller's perspective, look for more deals to spin off non-core lines of business. Companies that choose to stick closer to more traditional life and accident products will be challenged to refocus on segmentation and marketing skills.

Buyers, meanwhile, will likely look to not just bolster scale in existing markets and operations, but also to add capabilities through M&As that might help generate growth — such as bringing in specialized talent and/or a wider product or geographic mix.

Figure 2. M&A trends for life & health

M&A activity has been quieter than expected, in part because many publicly-traded carriers have preferred to bolster their share value through stock buybacks, but that trend may be playing out, prompting a more active year ahead.



Source: SNL Financial

- Transactions represent US and Bermuda Life & Health Insurance Underwriters making acquisitions on a global basis.
- Transactions grouped by the year they were announced. 2013 captures the year to date period as of Oct. 4, 2013.
- In 2012, the following deal was excluded from the average observed deal multiples as it skews the data: Cigna Corporation's acquisition of Finans Emeklilik for 6.6x P/B.
- For the following years there was only one transaction with disclosed P/B multiples: In 2009 Pope Investments II LLC / Annuity & Life Re (Holdings), Ltd. for 0.87x P/B.
- Deal multiples represent closed multiples, unless the transaction is still pending close.
- For 2013, while the data sources indicated the deal size for most of the transactions, information for the P/BV for the individual transactions was not available.

The bottom line

Be prepared for a more dynamic mergers and acquisition market in 2014, as opportunities to acquire books of business and/or particular capabilities may increasingly become available, and the ability to finance deals remains favorable even with a slight uptick in interest rates. Valuations are finally on the upswing, perhaps encouraging more insurers to take the plunge and attempt a sale. There also may be more buyers in the market as the momentum from stock buybacks continues to lose steam.

In any case, carriers should reassess their strategic direction, then start to identify and vet potential targets where an M&A might help bolster their scale and market reach, especially at a time when profitable organic growth remains difficult to achieve.

Insurers look to evolve products, mindset, to expand growth horizon



The dynamics driving traditional insurer growth strategies are changing dramatically and players will look to keep pace in order to remain competitive. Historically lucrative products and target markets are no longer producing sufficient returns, and tweaks to current strategies may not have a dramatic impact on growth and market share.

The bread-and-butter demographic for life insurers — the profitable, affluent baby boomer segment — has become quite saturated. However, acquisition costs are often too high to incentivize many agents to spend time selling to underpenetrated segments, including Gen X and the middle market. These untapped demographics may require different targeting and sales techniques than the ones developed for the mass affluent, or for those nearing retirement.

Consequently, those who can figure out how to cost-effectively bridge the coverage gap of the under- and uninsured could potentially appropriate the lion's share of this market. However, infiltrating new demographics will require novel approaches to make the efforts worthwhile for stakeholders.

More tech savvy, but perhaps less financially confident than the baby boomer set, Gen X and middle-market consumers will likely respond better to simplified products made available through a wider variety of distribution options.

Meanwhile, insurers are seizing opportunities to shift private sector pension liabilities to individual annuities, as more corporations look to lay off their legacy retirement obligations. This provides a conduit to effectively create a new group annuities market, featuring more capital efficient products and services than carriers might be able to market to individual buyers. This could significantly increase the pool of assets insurers manage, and generate a much-needed infusion of revenue.

What's new for 2014?

In 2014, look for more life and annuity carriers to begin developing simplified products and more cost-efficient strategies to target underpenetrated and emerging market segments, as methodologies shift from 'sharing the proverbial pie' to 'enlarging the size of the pie'.

The historically underpenetrated Gen X demographic provides a tempting target for carriers, as well as life and annuity agents and other intermediaries looking to increase their client base, given the segment's stated desire to buy life insurance coverage potentially worth \$3.6 trillion over a 12-month period — higher than other demographic segments, according to LIMRA.¹

By paying closer attention to Gen X expectations and needs, including simple products that offer value that are bought and serviced over varied but integrated distribution platforms, insurers might more effectively connect with this segment.

Insurers will also explore broader distribution platforms, including alliances formed with retailers that Gen X frequents, such as the MetLife alignment with Wal-Mart to sell simple life policies at the latter's stores.

Moreover, setting up highly-engaging online communities along with an interactive and easy-to-navigate multi-media website could give insurers cost-effective platforms to engage with tech-savvy Gen Xers and gain deeper consumer insights. One leading life insurer developed an online interactive tool to alleviate the factors that often discourage this segment from buying life insurance. Gen Xers' high brand loyalty is very likely to help defray initial acquisition costs through additional product sales over time.

The establishment of private online health insurance exchanges, spurred by the market disruption created by

¹ Life insurers cast the net wider for growth: Enter Gen X, Deloitte Development LLC, 2013.

the Patient Protection and Affordable Care Act, could also provide a potential low-cost growth platform for insurers looking to expand their client base — particularly among the historically underpenetrated low-to-middle income and small-business segments.

While carriers are unlikely to cross-sell life, accident, and disability products along with health coverage on such exchanges in the very near future, now is likely the time to identify potential partners and consider how such cross-selling experiments might work so that carriers are not trumped by more aggressive competitors. Simplified insurance products and intuitive straight-through processing will likely be required to make this option a reality.

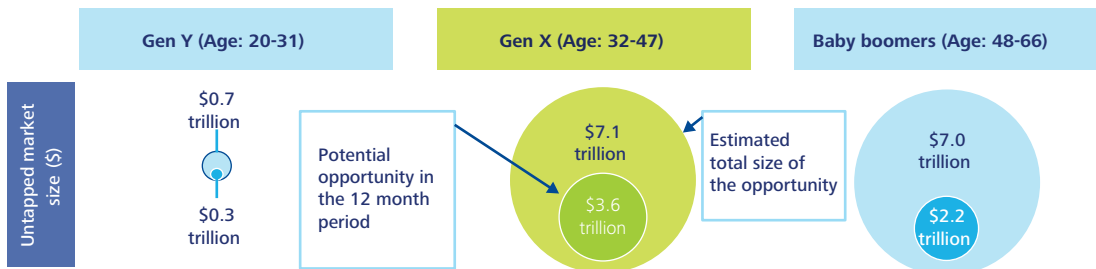
The bottom line

Insurers will need to decide whether to continue down traditional paths and hope for different outcomes, or transform their approach to customers and products. Simplicity and capital efficiency will likely be the factors driving such fundamental changes for insurers looking to achieve meaningful organic growth. Easier-to-understand product options should be developed to counter the adage that insurance is sold and not bought, opening up opportunities to target demographics historically wary of the industry’s traditional sales pitches and discouraged by complex, difficult to understand coverage.

Targeting underserved segments will also require specialized marketing, engagement options through various distribution channels, and loyalty-building strategies, which will help defray initial acquisition costs. Moreover, life and annuity insurers should begin considering how they might capitalize on the emerging group annuities market and health insurance exchanges to potentially benefit from enhanced access and sales efficiency.

Figure 3. Life insurance sales potential by generation

Insurers that use novel approaches and innovative strategies to cost-effectively bridge the life insurance coverage gap within the 32-to-47-year-old age bracket can potentially appropriate the lion’s share of this vastly underpenetrated market.



Source: Trillion Dollar Baby — Growing Up. The Sales Potential of the U.S. Underinsured Life Insurance Market, LIMRA, 2011.

Regulatory uncertainty over reserving, captive use may leave insurers in the lurch



The Federal Insurance Office (FIO) came out in December with its long overdue report on how insurance regulation could be modernized and improved.

“The FIO report in some respects is a challenge to state regulation but overall is not likely an immediate threat to state supremacy,” says Howard Mills, chief advisor for the Insurance Industry Group at Deloitte Services LP. “Most of FIO’s recommendations require Congressional action, which is not expected anytime soon, or is a call to the states to make changes, which FIO cannot now compel. The bottom line is that there is likely to be little immediate impact, but continued uncertainty over a slowly evolving regulatory landscape shaped by how the states and federal government interact.”

Going forward, minimizing the effect of regulatory changes on the cost of capital while complying with an expanding list of regulatory requirements sums up the compliance challenge facing life insurance companies in 2014. Along with topics of immediate concern such as the use of life insurer-owned captives for reinsurance, and issues with principle-based reserving (PBR), insurers now have to contemplate medium-term changes — many related to the globalization of insurance regulation — such as global Insurance Capital Standards (ICS), as developed by the International Association of Insurance Supervisors under the direction of the G-20’s Financial Stability Board (FSB).

Difficulty in gaining national adoption of PBR may have been the biggest regulatory development for life insurers in 2013. The industry has long sought to right-size reserves through PBR implementation, and this had been identified as a top priority of the National Association of Insurance Commissioners (NAIC) since its adoption by that body in December 2012.

However, final implementation of PBR has been problematic, given that it barely got the required supermajority at the NAIC and requires a similar supermajority of state legislatures to implement the

enabling legislation. Even if PBR is adopted by the required supermajority, companies may nonetheless face the burden inherent in having to meet two very different sets of reserving requirements.

The status of insurer-owned captives used for reinsurance is another major concern for life insurers, with regulators citing worries about the offloading of hundreds of billions in liabilities to subsidiaries in jurisdictions with different reserve requirements. Regulators fear that such intra-family reinsurance arrangements may circumvent statutory accounting requirements and expose policyholders to greater risks.

Concerns about both developments were strongly expressed in the FIO’s report.² On captives, the FIO cited a state study that found “reserves were diverted and risk-based capital was artificially boosted,” and that reinsurance captive use “accounted for \$48 billion of ‘shadow insurance’ capital manipulation.” The findings in that one state alone were among the reasons to call for a uniform and transparent oversight regime for the transfer of risk to such entities.

The FIO report also called for states to “move forward with substantial caution” with the implementation of PBR, citing the need for consistent, binding, regulatory guidelines as well as the availability of required resources, and proper oversight of vendors providing consulting services to the states.

In addition, FIO recommended “character and fitness expectations” for directors and officers, adding steam to the NAIC’s efforts to enhance corporate governance requirements.

What’s new for 2014?

The NAIC and FIO are both conducting reviews of captive use by life carriers, with recommendations on how to respond expected in 2014.

² “How to Modernize and Improve the System of Insurance Regulation in the United States,” Federal Insurance Office, December 2013.

“If restrictions are placed on the use of parent-owned captives to cover life insurer risks, that development could have significant consequences,” according to Mr. Mills. “In addition to possibly having to make up for a capital shortfall, regulatory changes could also mean that certain items allowed for use by captives but not by the parent company under statutory accounting — letters of credit, for example — may likely have to be replaced by more costly sources of capital.”

A medium-term concern may be the FIO report’s call for standardized guaranty fund limits nationwide. If that leads to higher limits in some states, it may increase liability for insurers operating in those jurisdictions.

There is also the continuing globalization of insurance regulation to take into account. The G-20’s powerful Financial Stability Board wants centralized regulation in the United States through the FIO, although the FIO’s report largely endorsed the goal of uniformity among states rather than centralized regulation. However, in some areas there is clear movement in the direction of de facto if not de jure national regulation — such as with its recommendation that the FIO and the U.S. Trade Representative enter into “covered agreements” with other countries on reinsurance collateral, with the FIO assessing the effectiveness of foreign regulatory regimes.

Both the FIO and the Federal Reserve Bank have assumed increasing importance in insurance regulation. The Fed is seeking to join the International Association of Insurance Supervisors, and reportedly would like a seat on the organization’s important Executive Committee.

The most important international development may be global Insurance Capital Standards, expected to be in place by the end of the decade. While this development is in its infancy, it does raise the question of how ICS can exist without a global accounting standard. That in turn raises questions about the future of statutory accounting and the convergence of U.S. GAAP and International Financial Reporting Standards.

The bottom line

Preparing for the NAIC’s Own Risk and Solvency Assessment and revised group supervision requirements is a clear priority as the filing deadlines draw closer. There is little insurers can do about principle-based reserving. However, given statements from individual state regulators and the FIO, life insurers may be wise to prepare to address and allay regulatory concerns about parent-owned captives if they wish to continue using them for reinsurance purposes. In addition to preparing for transparency and standardization, this may include examining and justifying the quality of the reserves held by captives, as well as demonstrating there is real risk transfer — in other words, that the captive is not just being used to avoid statutory accounting requirements.

Transforming finance to become business partners



Finance is more often being asked for decision support and strategic advice within insurance companies, prompting transformation initiatives to evolve the function into an internal business partnering role by strengthening its link to broader enterprise goals, such as product focus and capital deployment.

In an increasingly complex business environment, finance functions at financial services organizations are expanding their capabilities to support the introduction of new products and markets, cost reduction initiatives, and efforts to achieve appropriate risk-adjusted returns, according to a Deloitte survey of chief financial officers.³

Business partnering in this context can be defined as the role that finance will assume to both support and challenge insurer initiatives. It is a shift from stewardship to strategic thinking, with finance looking to create value by improving the quality of business decisions, while helping realize the highest financial value for a particular initiative at what is considered to be an acceptable level of risk. The challenge is for finance to develop into an effective internal business partner to enhance strategy formulation and execution, while maintaining its stewardship and control capabilities.

Carriers are also looking to prepare for new financial information demands from regulators, generated by the NAIC's Own Risk and Solvency Assessment initiative, the European Union's Solvency II directive, and other such calls for data and analysis. Finance will likely play a major role in scenario planning, stress testing, and other efforts to comply with new oversight requirements.

A number of insurers continue to face challenges in finance when it comes to adapting legacy systems to meet these evolving data demands. Deloitte's research into business partnering among finance leaders in 11 industries found that while technology is a key enabler, it can also be an obstacle in effectively supporting the business, thus driving the need for transformation efforts. The survey showed

that even when finance business partners have the correct data, they often have to spend significant time manipulating it to make it relevant for strategic business purposes. Indeed, 57 percent ranked "finance systems inhibiting access to data" as a top-three barrier.⁴

What's new for 2014?

A growing number of carriers are poised to move further along the finance maturity curve so they may become true internal business partners, while also upgrading their systems and capabilities to provide the data and insights required to meet increasingly stringent regulatory demands.

Under Deloitte's "Four Faces of Finance" framework⁵ (Figure 4), "Stewards" tend to emphasize protecting company assets and ensuring compliance with financial regulations, while "Operators" generally support efficient finance operations and service delivery. However, business partnering likely requires taking the finance function to the next level. "Strategists" help determine business direction and align financial strategies, while "Catalysts" look to proactively stimulate behavior to achieve strategic as well as financial objectives.

Therefore, expect finance functions at a growing number of insurers to move towards partnering, and in the process become more integral contributors as Strategists and Catalysts in key business activities — including target-setting, forecasting, capital investments, risk management, and governance. The drivers are two-fold, one being regulatory demands for stress testing and scenario planning, with the other being the need to better integrate finance into overall business partnering.

To reach this higher stage of transformation, finance will likely need to collaborate more closely with other functions, such as risk management, than may have been the case historically. To accomplish this, insurers will look to bring together financial and operational data,

³ CFO Signals™ Survey, Deloitte LLP, 2013.

⁴ Finance Business Partnering Survey: Changing the Focus of Finance, Deloitte LLP, 2012.

⁵ Unlocking the Potential of Finance for Insurers, Deloitte Development LLC, 2013.

which often is not within the current reach of finance. As a result, they will also likely need greater information technology support to produce the types of data being sought for both business purposes and regulatory needs.

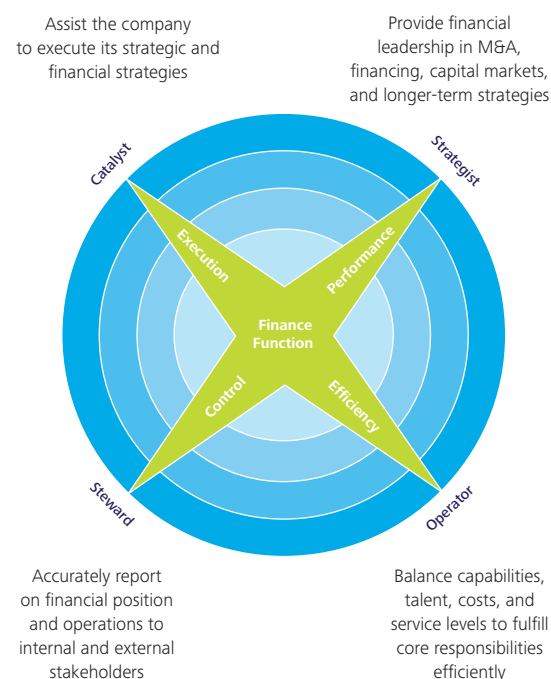
As companies transform financial processes, the lines of business, risk, and tax departments will look to reevaluate and improve the availability and quality of information, especially in relation to non-SEC/financial reporting data, as they seek to bolster business intelligence, predictive analysis, risk management, and capital allocation.

Talent can be a differentiator. Carriers looking to bolster their finance capabilities may need to develop or recruit those with certain critical competencies, such as commercial acumen and decision-making skills, strategic thinking, and the ability to influence and even challenge enterprise decisions.

In addition, there could be an increased utilization of outsourcing in the finance area for more routine activities, to facilitate a greater focus on core strategic, business-partnering priorities in-house.⁶ Insurers also have an opportunity to reexamine and streamline their control processes to better align with the new COSO⁷ framework — to ensure that any risks emerging from increased outsourcing and use of third-party services are well managed.

Figure 4. The four faces of the finance function

While many carriers likely reside at the early stages of finance transformation, focusing on improving the roles of Steward or Operator, expect a growing number to assume a more proactive role.



The bottom line

Insurance players should take a more holistic approach to their finance transformation initiatives, exploring how finance could create greater value by playing the role of a Strategist and perhaps Catalyst in decision-making on broader company challenges. The resulting finance model design should be flexible and scalable to remain in sync with an insurer’s evolving business model evolution and operating philosophy.

Without sacrificing their stewardship role, finance leaders should develop a plan to align with higher value enterprise activities so they may become more valuable business partners with their internal clients. To evolve in this direction effectively, partnering competencies should be built or imported into finance — an area where recruitment and development efforts have traditionally focused more on acquiring or developing technical proficiency rather than a broader business skill set.

⁶ 2012 Global Outsourcing and Insourcing Survey, Deloitte Consulting LLP. (The survey results are based on all major industries and regions with 15 percent of participants from FSI.)

⁷ COSO is the Committee of Sponsoring Organizations of the Treadway Commission, a joint initiative of five private-sector organizations that develops frameworks and guidance on enterprise risk management, internal controls, and fraud deterrence.

People power can make the difference in transformation efforts



Prolonged periods of slow growth, heightened competition, and a drive for capital efficiency have combined to spur more carriers to reconsider how they conduct their business. The question, however, is whether insurers will settle for tweaks to produce short-term boosts in efficiency, or instead make bolder moves to overcome more fundamental challenges in their business models and position themselves to possibly leapfrog ahead of their competitors.

"While carriers should continue to seek bottom-line improvements by squeezing out unnecessary costs, they should also be looking to make more sustainable efficiency and productivity plays," says Neal Baumann, global insurance sector leader at Deloitte Consulting LLP. "In order to achieve more impactful changes, they will likely need to rethink core operating models and how to more effectively leverage key capabilities across the enterprise."

Included could be efforts to build more strategic marketing capabilities targeting underserved segments, upgrade technology systems to more effectively leverage underwriting and pricing data for competitive advantage, as well as assess alternative distribution options to reach a wider array of consumers at a more economical cost.

One message that resonates throughout this outlook, however, is that people power, not just process or system changes, can be one of the biggest factors in any transformation effort. Whether an insurer is looking to build marketing capabilities to reach underserved segments, become more analytics-driven in data management efforts, or make the finance operation an internal business partner, the people on staff and the skills they bring to their jobs could become a competitive advantage, as carriers alter business models and infrastructure to up their games.

Yet talent recruitment and development remains a significant challenge for many carriers. "Despite relatively high unemployment, there is a shortage of qualified workers steeped in specialized skills insurers crave, including advanced analytics, predictive modeling, mobile technology and other abilities in high demand, leaving the industry to cope with a talent paradox — having millions unemployed, but few ready, willing and able to step in and help insurers transform their operations," according to Andy Liakopoulos, a principal in the Human Capital Practice of Deloitte Consulting LLP.

Insurers are competing not just with one another for such highly-skilled talent, but with other financial services sectors and many other industries as well, particularly those in the high-tech fields. Exacerbating this problem are overall demographic concerns, with a generally older and aging insurance work force in many important functions pointing to what is likely to be a widening gap in the supply of talent in the face of increasing demand.

The rapid adoption of data-driven initiatives has widened the talent gap for insurers, given the economy-wide demand for individuals with analytical skills. Therefore, attracting, developing, and retaining employees with such specialized capabilities remains a significant hurdle to overcome and a potential differentiator for those that do.

Beyond recruiting challenges, "a silo mentality tends to limit the ability of many carriers to effectively create alternative career paths for those with skills that might be adaptable for other, more pressing needs within the company," added Mr. Liakopoulos, who leads the U.S. Talent Strategies practice at Deloitte Consulting LLP.

What's new for 2014?

Carriers will more aggressively start transforming their core operating models to be more responsive, nimble, and cost-effective. To support these changes, top management will be challenged to make strategic investments to overcome organizational obstacles to flexibility and growth, particularly when it comes to data management and distribution.

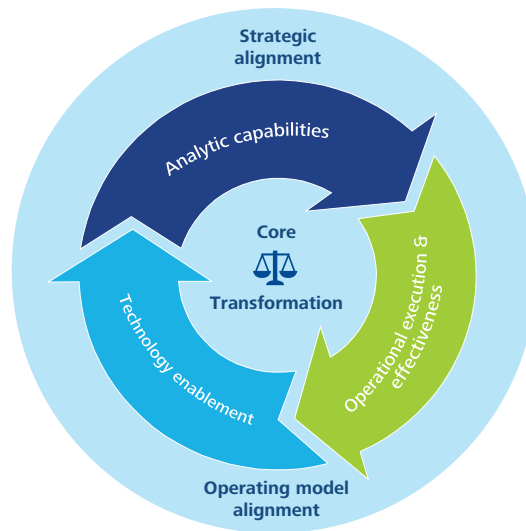
On a more fundamental level, insurers will likely consider adjustments to their employment model. "They may broaden recruiting strategies by determining the basic competencies required for hard-to-fill positions, and then actively target candidates not just from outside the company, but beyond the industry as well — for example, hiring out-of-work teachers with math skills who can be retrained for a career as an actuary or data analyst," according to Mr. Liakopoulos. "They could also look to bolster continuing education and cross-training programs."

In addition, insurers may adjust their performance management and compensation systems to focus more on developing the talent they already have in-house. The goal will be not only to improve retention of highly-skilled, experienced employees at a time when competition among carriers for talent will be fierce, but to more proactively encourage and facilitate flexibility and productivity among their entire work force.

And instead of viewing career growth as a vertical progression within a business line or operating unit, carriers will look to create a more flexible career lattice, where individuals are given the opportunity and rewarded for extending their functional skills laterally across multiple lines and departments. This could make the employee more productive and valuable for the organization while creating additional paths for career advancement.

Figure 5. Core system transformations on the rise

Talent, not just process or system changes, can be one of the biggest factors in any transformation effort. Yet carriers are having a hard time finding and retaining those with the necessary skill sets in key areas, including those capable of handling advanced analytics and predictive models.



The bottom line

Transforming operating models will likely take some creative thinking and perhaps even risk-taking by management teams that will be challenged to leave their comfort zones by making dramatic changes in the status quo, including ongoing innovation in product design, underwriting, marketing, and distribution. Meanwhile, talent recruitment and career development should be redefined to staff insurers with the skill sets required to fuel the transformations already underway and still to come.

Tech investment can be a critical component for innovation

As more insurers look to transform their operating environment, technology investments are moving to the front burner for life and annuity carriers, across the industry's entire value chain. From the evolutionary advancements of enabling systems to the revolutionary capabilities of more disruptive elements, insurers should be positioning themselves to take advantage of the opportunities for gains in flexibility and efficiency, or risk falling behind in the technological arms race.

Despite prior investments toward tech modernization, many organizations still have deficiencies to address, such as legacy systems that impede data management and analysis. At many insurers, the tech infrastructure is either too rudimentary or lacks the predictive tools to adequately support the accelerating role of advanced analytics. These enabling systems will require reexamination due to the upsurge of emerging applications to enhance or reinvent underwriting, distribution, customer engagement, and other critical areas.

As a result, carriers are considering adoption of more disruptive technologies to address increasingly fluid and sophisticated preferences and expectations on the part of consumers and intermediaries. For example, tech-savvy agents, brokers, and financial planners covet online and particularly mobile technology capabilities for more engaging customer interactions.

While incorporating new tech systems, insurers need to beware of their susceptibility to increasingly sophisticated cybercrime and data privacy breaches.



What's new for 2014?

Covering the entire gamut, from distribution to data management, investing in technology will continue to move to the forefront of insurers' 2014 agendas.

Insurers will consider investments in enabling technology, as the increase in volume, velocity, and variety of external data may stress the sector's aged and siloed infrastructure, threatening to overwhelm enterprises that haven't yet tackled the primary impediments to information management.

Moreover, to more effectively capitalize on advanced analytics and predictive modeling, insurers will likely boost investments in organizational and systems modifications to better leverage data as a strategic asset. Predictive analytics could fuel a growing number of functions for insurers, including behavior-based pricing as well as target marketing based on predicted interest, perceived value, and anticipated life events.

Look for insurers to also invest in more disruptive technologies to revolutionize how information and services are delivered, as well as where decisions are made and transactions occur. Life carriers will likely become more aggressive in developing mobile tools for agents and other intermediaries to generate more engaging discussions with clients. According to Arun Prasad, a principal and technology specialist with Deloitte Consulting LLP, "these efforts will likely entail the use of tablets, as opposed to mobile phones, due to the nature of the consumer/intermediary interaction."

Mobile technology will focus on providing the ability to produce dynamic graphical models that illustrate how the value of policies or investments will change over time, helping consumers really understand their products in an engaging way. Improved digital illustrations can allow intermediaries to more efficiently educate the end consumer on the importance of savings, as well as taking a more holistic approach to retirement planning, while strengthening their credibility by showing rather than just telling about the benefits of their products and services.

Mobile apps will also be increasingly available for other lines. For example, the Council of Disability Awareness offers an app that works as an educational game to allow users to gauge their disability likelihood and learn about how to protect against it.

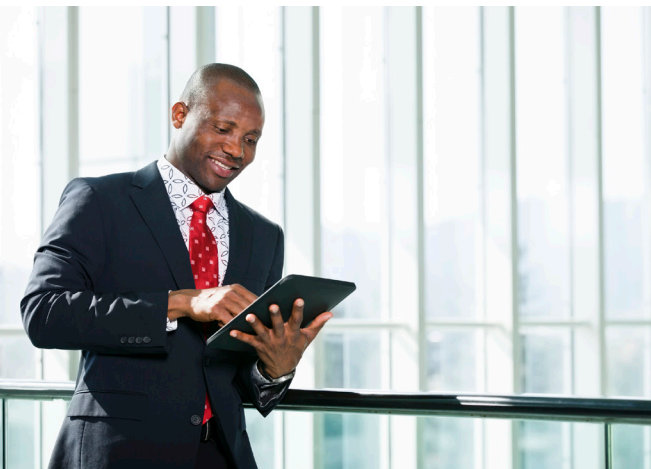
All the while, the threat landscape will continue to progress as cybercrime perpetually evolves and new technology is integrated with legacy environments. Information security officers will need to become more sophisticated to fend off potential threats and protect client data, while maintaining the insurer's reputation and avoiding potential consumer lawsuits and regulatory actions.

The bottom line

The improving economic environment can provide life and annuity carriers with an opportunity to invest in large, transformational technology projects to meet the evolving demands and expectations of customers and channel partners alike. Insurers should accelerate efforts to modernize their systems to enable fluency and compatibility with digital platforms and new sources of data. Tech upgrades should embrace data analytic capabilities to enable more targeted marketing campaigns, better pricing of risks, and a personalized customer experience.

While such tech investments could be sizable, "analytics and technology development may provide the opportunity for potential tax credits, possibly making such projects less costly on a bottom-line basis," according to Chris Puglia, a partner at Deloitte Tax LLP.

In line with technology modernization, insurers should continuously reexamine and upgrade their ability to protect sensitive customer data from the prying hands of cybercriminals.



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Where should insurers go from here?

The last few years have been particularly difficult for those occupying C-suite positions in the industry, as more fundamental issues are threatening not only short-term results on their balance sheets, but the long-term viability of their business models as well.

The question is which carriers will have the vision and ability to proactively anticipate and adapt to new market realities. Those that do are more likely not just to survive, but to prosper as they reposition themselves against traditional as well as emerging competitors.

Leaders across the insurance organization have some difficult decisions on the agenda in the year ahead, about the fundamental ways in which they do business.

Some thoughts for the road

Among the questions insurers should be asking of their leadership teams:

- What can I do to transform my operating model to improve my organization's ability to target underserved markets and more effectively reach them? How might I generate more actionable market research, leading to practical segmentation?
- Ultimately, how can I enhance the customer experience and the relevance of my products and services? How can insurers keep up with the demand for 24/7 accessibility and immediate gratification consumers have come to expect from other industries outside of financial services? How might they find the right balance and account for the cost of offering multiple distribution systems, if they choose to go that route?
- Would a strategic merger or acquisition help make up for the lack of organic growth while improving the bottom line? Might a deal be the ticket to achieving scale, enhancing capital efficiency, and expanding market share? Would an acquisition make sense in terms of importing new markets, capabilities, and talent?
- Can insurers simplify their product offerings and expand their distribution options to not just become more competitive for the industry's traditional target markets, but actually expand the overall pie by reaching underserved and underdeveloped consumer segments?
- How should insurers deal with regulatory uncertainty? How can they better integrate regulatory considerations into strategic scenario planning, involving all C-Suite inhabitants? Can nimbleness in responding to regulatory requirements be turned into a competitive advantage?
- How might insurers alter the way they recruit and develop talent so that they close the widening skills gap in their organizations? And how can they create a more flexible career path to retain their most valuable employees, while being positioned to quickly move individuals to areas within the company where their skill sets are most urgently needed?
- What can insurers do to evolve their finance operation into more of an internal business partner to help identify and capitalize on growth opportunities, without neglecting the function's traditional stewardship role? What skill sets need to be developed or imported to make such a transformation a reality?
- How might an insurer gather and synthesize new types of information to gain actionable insights? And how can the organization improve the way it correlates the data it already gathers in the normal course of business across lines and processing systems?

“There are usually tactical steps insurers could take to make a short-term course correction, and tweaks can often be implemented to adjust systems and processes. But to capitalize on emerging opportunities instead of being undermined by the disruptive changes likely to alter the competitive landscape, top insurance executives should be more predisposed towards bigger-picture innovations,” says Gary Shaw, U.S. Insurance Leader for Deloitte LLP.

“Whatever the challenge, this outlook indicates that simply maintaining the status quo is likely no longer a sound business strategy no matter which operating model is employed by a particular insurer, given the macro- and microeconomic trends buffeting the industry from all sides,” Mr. Shaw added.



Contacts

Industry leadership

Gary Shaw

Vice Chairman
U.S. Insurance Leader
Deloitte LLP
+1 973 602 6659
gashaw@deloitte.com

Deloitte Center for Financial Services

Jim Eckenrode

Executive Director
Deloitte Center for Financial Services
Deloitte Services LP
+1 617 585 4877
jeckenrode@deloitte.com

Authors

Lead author

Sam Friedman

Research Leader, Insurance
Deloitte Center for Financial Services
Deloitte Services LP
+1 212 436 5521
samfriedman@deloitte.com

Co-authors

Michelle Canaan
Manager
Deloitte Services LP

Nikhil Gokhale
Assistant Manager
Deloitte Services Pvt. Ltd.

Jaykumar Shah
Senior Analyst
Deloitte Services Pvt. Ltd.

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Amy Allen, Senior Manager, Deloitte Consulting LLP
Neal Baumann, Principal, Deloitte Consulting LLP
Greg Domareki, Senior Manager, Deloitte Tax LLP
Tami Frankenfield, Director, Deloitte Consulting LLP
Richard Godfrey, Principal, Deloitte & Touche LLP
Doug Gray, Partner, Deloitte LLP, Canada
Neil Harrison, Partner, Deloitte LLP, Canada
Karl Hersch, Principal, Deloitte Consulting LLP
Mark E. Hopkins, Director, Deloitte Consulting LLP
Brad Howard, Senior Manager, Deloitte Consulting LLP
Daniel Leff, Specialist Leader, Deloitte Consulting LLP
John Lucker, Principal, Deloitte Consulting LLP
Boris Lukan, Principal, Deloitte Consulting LLP
Andrew N. Mais, Senior Manager, Deloitte Services LP
Howard Mills, Director, Deloitte LLP
Naru Navele, Partner, Deloitte & Touche LLP
Arun Prasad, Principal, Deloitte Consulting LLP
Chris Puglia, Partner, Deloitte Tax LLP
Ash Raghavan, Principal, Deloitte & Touche LLP
Kevin Sharps, Principal, Deloitte Consulting LLP
Doug Sweeney, Director, Deloitte FAS LLP
Adam Thomas, Senior Manager, Deloitte & Touche LLP
Christopher Tutoki, Partner, Deloitte Tax LLP
Doug Welch, Director, Deloitte Consulting LLP
Marc Zimmerman, Director, Deloitte Consulting LLP

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Rachel Moses, Senior Marketing Specialist, Deloitte Services LP
Courtney Scanlin, Insurance Marketing Leader, Deloitte Services LP
Aditya Singh, Assistant Manager, Deloitte Services India Pvt. Ltd.

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