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2017 Insurance Outlook

Nimble will be the new normal in 2017 as insurance companies confront a marketplace that is changing more drastically than perhaps ever before. In addition to macroeconomic, social, and regulatory changes likely to impact the industry, insurers are coping with longer-term, game-changing trends. The increased connectivity among household and workplace devices, the development of autonomous vehicles, and the rising threat of cyberattacks are transforming the way people live and the risks they need to mitigate with insurance products. Insurers will need to adapt their business models to address these changes, which can be viewed as both threats and opportunities for growth.

Economic outlook: Uncertainty will impact insurer growth prospects in 2017

The US economy is heading into unknown territory with a new party in control of the White House, putting regulatory reform, trade policy, and the tax system on the table. Meanwhile, international economies have hit major speed bumps, thanks to the United Kingdom's withdrawal from the European Union (commonly known as "Brexit") and negative interest rates in some countries. Together, these underlying conditions could make for a challenging year ahead for insurers.

Low interest rates have continued to pressure investment income, a condition that will likely persist in the near-to-medium term despite expected rate hikes. However, bond volatility did rise right after the 2016 election in anticipation of bigger deficits and higher inflation.

Will infrastructure spending jumpstart the economy? Pre-election forecasts of a flattening trend in consumer spending could undermine insurer growth prospects, particularly if interest rates start to rise in regular intervals, possibly discouraging business and consumer borrowing. However, pledges to boost infrastructure spending, if realized, could positively affect gross domestic product and job creation.

Employment outlook dims for workers' compensation insurers. While the economy gained millions of jobs and unemployment decreased substantially over the past few years, the pace of employment growth has been slowing down. Innovations such as robotic process automation and autonomous vehicles threaten to dramatically shrink the number of insurable workers over the next decade. At the same time, automation may help insurers lower their labor costs, but likely not enough to offset the potential loss of premium income.

Homeowners market growth subject to economic and cultural shifts. A resurgent housing market boosted insurable exposures and premiums written, although this trend appears to be losing momentum. The rise of smart homes and the sharing economy may prompt shifts in policy design and demand in the medium- to long-term.

Changes in the auto industry pose existential threat to insurers. Unfavorable loss developments in frequency and severity may keep the growth in new vehicle sales from boosting auto insurer profitability. Longer term, the move toward autonomous vehicles and ride-sharing threatens to eliminate millions of insurable risks, although commercial auto insurers and product liability carriers could benefit from these trends from shifts in responsibility and ownership.

Property and Casualty (P&C) sector outlook: Cutting costs and modernizing operations

Insurers are starting 2017 on a strong financial base with average capital and surplus at its highest level in 10 years. However, excess capacity is undermining profitability, as seen by falling net income and return on average equity (ROAE). High capacity is expected to continue exerting downward pressure on rates and ROAE, especially in commercial lines, as insurers compete with new and existing players for market share in an overcapitalized environment and a slowly growing economy.

Growth opportunities. Insurers may confront major challenges in the face of uncertain economic expansion, rising but still low interest rates, emerging exposures, and an evolving economy, spurring more experimentation with new types of products, services, and distribution platforms. But there are opportunities for nimble companies to develop products for such emerging markets as usage-based insurance for vehicles, homes, and business coverages, while expanding cyber insurance sales and cyber risk management services.

Operational transformation. Insurers will likely need a laser focus on expense optimization to help offset the impact of a softening commercial lines market, a problematic personal lines segment, and a low-yield investment climate. Companies should consider addressing these issues by making greater use of advanced analytics; exploring InsurTech applications including blockchain digital ledgers and smart contracts; transitioning routine data collection, analysis, and compliance tasks to more cost-efficient robotic process automation; and adopting new distribution options such as direct-to-consumer small business insurance sales.

Potential speed bumps. Insurers face a number of challenges that could undermine their ability to bolster market share, profitability, and innovation. These include the possibility that auto safety technology, the ride-sharing economy, and autonomous vehicles could lower premium volume substantially; the question of whether telematic data really produces superior underwriting and pricing; and how best to balance the benefits of the Internet of Things with the cyber risks that connected devices present.

Life Insurance and Annuity (L&A) sector outlook: Driving growth through technology modernization

Amid challenges from regulatory disruption, increasing consumer expectations, and stagnant sales, insurers will likely look to accelerate technology modernization to drive growth and efficiency. L&A carriers face major systemic challenges—including pressures on profitability, new sources of competition, and evolving customer preferences—creating a need to develop innovative products and new distribution platforms.

Growth opportunities. New products, services, distribution channels, and sales and marketing techniques are becoming essential to spur faster growth in an underinsured market. For example, insurers can leverage telematics and IoT technology to make their life products more relevant to buyers with healthy living incentives, investment tips, and dynamic pricing, while robo-advisers can bolster life and annuities services for middle-market prospects. In addition, many consumers may be shying away from complex L&A products that are hard to understand, so look for development of simpler policies designed to meet clearly defined needs, such as guaranteed income in retirement.

Operational transformation. Legacy systems will require modernization to stimulate heightened efficiency, more precise risk selection and pricing, and stronger insurer/client relationships. Insurers can use such techniques as advanced analytics, robotic process automation, and other emerging InsurTech applications for core operations to streamline sales and underwriting and make the customer side of transactions more user-friendly.

Potential speed bumps. Life and annuity carriers face a number of challenges, including relatively modest economic growth, low interest rates, and regulatory uncertainty. Even if, as expected, interest rates finally start to rise in 2017, increases from current historic lows are likely to be small and spread out. This, along with slowing global economies, could make it difficult for insurers to generate the returns they need to attract and retain clients. At the same time, insurers may get a reprieve from the Department of Labor's (DOL) new fiduciary regulations, but could still see a less-demanding version of the rules go into force, depending on the dynamics of the change in power in Washington.

Cross-sector insurance trends:

Mergers and Acquisitions on the upswing?

The stars may be aligning for increased M&A activity in 2017, given the tailwinds in the second half of 2016. However, the 2016 election results have created uncertainty about the economic climate, which may give some insurers pause about their short-term strategy. Volatility in deal volume and size among individual segments of the business should be expected in any case, thanks to the following factors:

- The US insurance market remains the largest globally on a premium-dollar basis, and it offers more growth potential than any other market, making domestic carriers attractive to foreign buyers.
- At the same time, InsurTech firms could have a disruptive impact by compounding the forces of change already reshaping the industry, while also being potential M&A targets for insurers.
- In addition, M&A activity could be spurred both by insurers looking to divest noncore assets for both regulatory and competitive reasons, and by those seeking acquisitions to increase scale and capabilities.

Regulatory outlook: International, national, and state issues

Heightened oversight could cause turbulence in 2017 as insurers cope with changing international, national, and state regulations:

- The International Association of Insurance Supervisors is working on a new worldwide regulatory framework for enhanced prudential standards that could impact insurers globally.
- Nationally, the 2016 election results have left the regulatory landscape in limbo as the new administration and Congress are expected to seek substantial changes to the Dodd-Frank Act, the DOL's new fiduciary rule, and other regulations.
- At the state level, regulators are addressing a number of issues, including principle-based reserving for life companies, market conduct examination standards, and cyber risk management.

Will tax reform spur technology investment and M&A activity?

Insurers may invest in technology and/or execute M&A deals to balance out the costs and challenges related to impending tax reforms. The prospects for significant tax reform increased due to the 2016 US election results. Reform could include lower corporate tax rates, a territorial tax system, and the loss of some deductions to offset the rate decrease. The potential for US tax reform also looms over life insurer reserve deductibility, tax treatment of offshore reinsurers formed by hedge funds and private equity funds, and other matters. Globally, compliance issues related to tax reform include major documentation requirements and added costs, as well as potential public relations matters arising if reporting information is made public.

What steps should insurers consider taking in 2017?

Insurers need to be nimble to prosper in a rapidly changing business environment. To adapt to today's rapidly evolving, consumer-centric culture, and increasingly technology-driven economy, insurers likely need to continually upgrade their operating systems, business models, and value proposition in 2017 and beyond. They should also consider undertaking an ongoing, holistic transformation of products, services, legacy systems, and business processes to drive growth, bolster efficiency, improve customer experience, and head off emerging competition. Potential steps include:

- Develop new products to meet emerging coverage needs in a sharing, connected economy
- Expand digital distribution and virtual service to cut costs and gain competitive advantages
- Enhance cyber risk management to stay ahead of evolving threats and comply with new regulations
- Treat technology modernization as a journey rather than a final destination
- Deepen client engagement beyond renewals and claims while differentiating with ancillary services
- Drive IoT strategies beyond auto insurance for personalized pricing and risk-management incentives
- Explore potential M&A opportunities to deploy excess capital, create scale, and add capabilities
- Facilitate InsurTech innovations by launching pilot tests and perhaps financing startups

However, even with increased automation, people power may yet prevail. On the staffing side, human capital can still make the biggest difference in securing a carrier's future growth and profitability, as companies are going to need talent not just to replace the growing percentage of those close to retirement age in the industry, but those with new types of skills as well — more data scientists, for example.

Meanwhile, customer centricity is also likely to be a major factor. The timeworn phrase, "the customer is always right," perhaps never has resonated louder than it does today, given the lack of brand loyalty and enhanced mobility of today's web-savvy consumers.

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