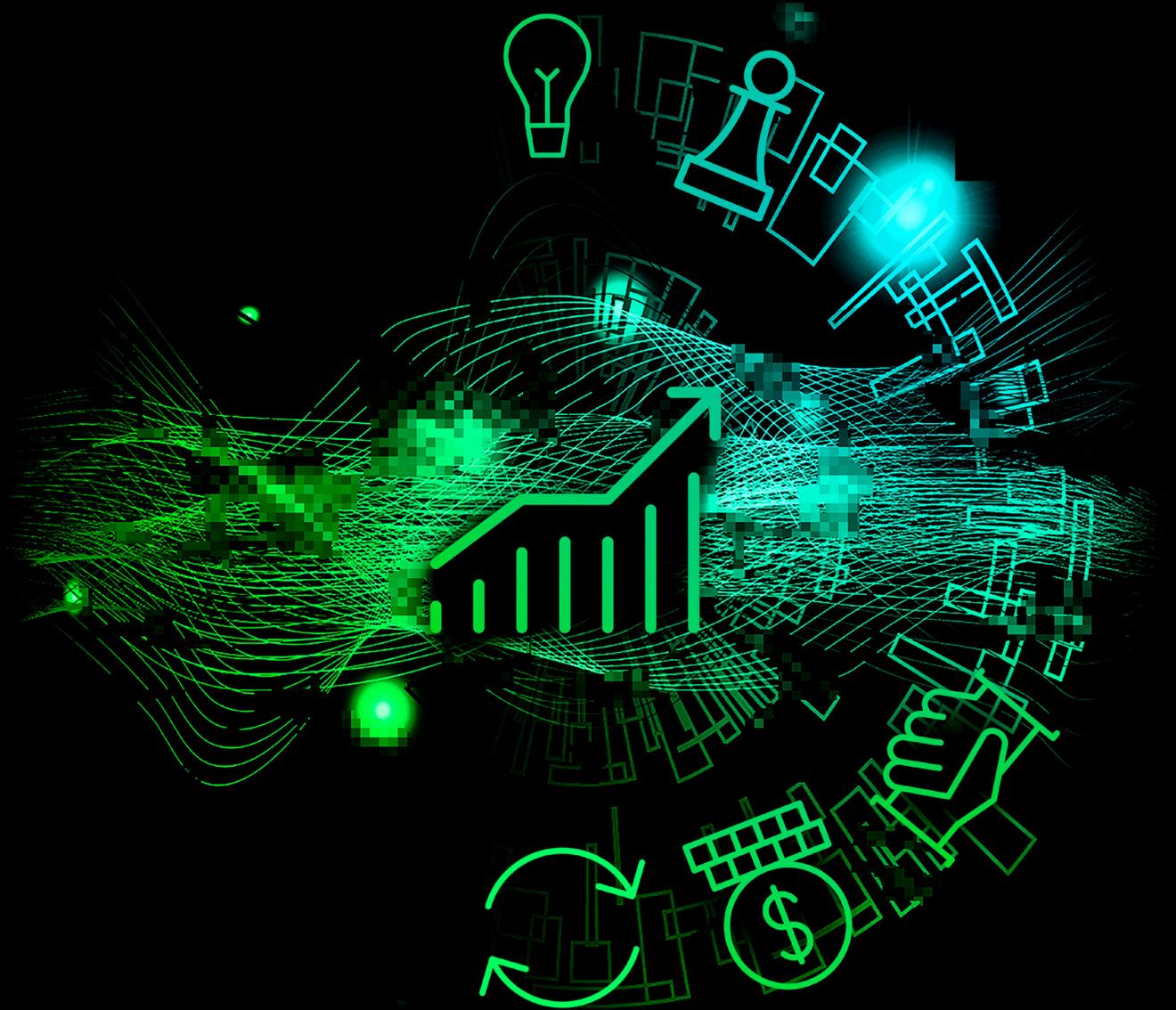


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**Accelerating insurance innovation
in the age of InsurTech**

Insurers of the future will need to
evolve and transform

Deloitte Center *for*
Financial Services

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Key messages



Most insurers remain focused on enhancing legacy systems, products, and business models, while neglecting to devote enough resources to more disruptive innovations that might differentiate them in an increasingly customer-centric economy.



To help accelerate innovation, insurers—which account for only one in four dollars invested in the maturing InsurTech market this year—should start dealing with startups more as an ecosystem of co-developers and partners, rather than just another vendor with a point-solution.



Insurers face increasing scrutiny by rating agencies that are now examining how effectively they initiate and manage innovation, but more importantly, how they demonstrate a measurable impact.



Improved technology alone cannot foster sustainable innovation unless accompanied by fundamental changes in insurance company strategy and operating models.



Ultimately, to futureproof their business, carriers will likely need to expand upon core innovations to jumpstart adjacent and transformational efforts, which could be facilitated by a dedicated team created to pursue new business models and seek alternate revenue streams in parallel with current system improvements.

To innovate, insurers should evolve as well as transform

Innovation covers a wide gamut of insurance company efforts, from upgrading and digitizing legacy operations, to enhancing the experience of policyholders, distributors, and employees, and ultimately to more disruptive changes in products, platforms, and services. All three elements are valuable to assure the industry's long-term competitiveness in an increasingly customer-centric economy.

Yet many insurers are devoting most of their attention and resources to maintaining or enhancing the status quo rather than differentiating their value proposition for the long haul. Both competitive priorities should be addressed, yet insurers are finding it difficult to strike a balance between the two for a variety of reasons.

To gauge the state of the industry in terms of innovation, we spoke with insurance carriers, InsurTech facilitators, and rating agencies. Without prompting, most estimated no more than 10 percent of innovation resources are going toward fundamentally changing how insurers do business, versus 90 percent to keep them running as they always have—only hopefully better, faster, and cheaper. The resource gap between maintaining and evolving how insurers do business will likely need to be narrowed considerably to fuel bigger picture innovation.

Fundamentally, insurers no longer own the narrative on innovation. Indeed, most transformative innovation is taking place and being financed outside the industry, thanks in large part to the InsurTech boom of the past decade. One global newsmagazine recently observed that “the future of insurance is happening without insurance firms,” while warning that as a result, “the industry’s plodding giants face mounting threats” from external disruptors.¹

Hippo Insurance, for example, which recently reached unicorn status by topping \$1 billion in valuation with its latest funding round,² offers a homeowners policy quote in 60 seconds via its website, along with a complimentary smart home monitoring system, a corresponding premium discount, and a “dedicated claims concierge.”³ Lemonade, another US-based homeowners and renters InsurTech carrier, which this year expanded into Germany,⁴ offers quotes in 90 seconds and processes claims in three minutes, while devoting a portion of profits to policyholders’ charitable causes.⁵

Balancing innovation priorities

This isn't to say insurers shouldn't be spending the majority of their time and money upgrading current operations. One rating agency pointed out that "cleaning up outdated and clunky legacy systems is a significant, worthy, and needed effort for an industry that hasn't been innovative or significantly disrupted in many decades." One global multiline carrier said spending on current process optimization is important "because if we can improve our combined ratio by a couple of points, that could translate into billions down the road." Additional money saved or revenue generated by such efforts could help fund future investment in more transformative innovations.

However, that same insurer emphasized business transformation is also an imperative. "We recognize that if we want to convince our shareholders and potential investors that we have long-term growth potential and are operating on the cutting edge, we have to inspire them with an innovation plan we can deliver on."

To spur sustainable growth, a better balance between status quo improvements and bigger picture investments should be considered—with longer-term efforts dedicated to creating new products, services, and customer experiences that can accommodate rising expectations for customization, flexibility, and convenience.

A second rating agency said they had yet to see a life insurance company implement innovation effectively enough to gain a significant competitive advantage. Such lack of innovation is perhaps one reason why US life insurers have generally been struggling to grow. Despite a relatively strong economy, life application activity fell 1.1 percent for 2018, and is up only 0.2 percent for the first half of 2019, with steep declines in interest among those under the age of 45.⁶

A global life insurer said more ambitious innovation will likely be required to grow the business by launching new revenue streams, product niches, distribution options, and service opportunities.

Innovation goes beyond technology

Achieving loftier and longer-term innovation goals will likely take more than upgrades in technological capabilities. Insurers should reimagine their operating models, talent needs, and market approach to become more customer-centric and keep up with increasingly agile InsurTech startups and proactive legacy competitors, as well as fend off potential threats from outside the industry entirely.

Carriers can evolve their standard operating procedures to serve customers seeking options to interact across the journey of "self-directed to guided." To accomplish that, operating models may require rewiring to enable more flexible interaction. Historical models are largely binary and difficult to build upon due to ongoing legacy constraints in people, process, and technology.

If market demands or competitive pressures aren't enough to prompt significant changes in how insurers innovate, note that rating agencies are making the subject a high priority in their assessment process. In fact, one agency is working on a template to quantify the maturity of an insurer's innovation program and its measurable outcomes. (See "Rating analysts raising the bar on insurer innovation efforts" on page 8.)

"Insurers need to get more serious about innovation," advised one private equity group investing in InsurTech. "Don't just put your toe in the water; dive in and immerse yourselves. Innovation should be part of everything insurers do, not just how they invest in or buy technology."

What's keeping insurers from innovating more effectively?

Most of the industry's innovation emphasis these days is placed on patching and shoring up its plumbing—upgrading and digitizing core systems or making small changes under the banner of innovation to demonstrate that something is being done. Far less is generally being spent on bolder innovations to enhance stakeholder experience—for customers, distributors, and employees. And even fewer resources are usually dedicated to what one rating agency referred to as “innovation with a capital ‘I’”—thinking and acting differently to

develop new products, markets, services, and business models. Those interviewed identified several major hurdles (see figure 1) hindering insurers from better balancing the need for innovation bolstering the status quo to keep up with competitors, versus differentiating for the long term.

Figure 1. Innovation inhibitors keep insurers from evolving more effectively

Internal obstacles hinder change management



Source: Venture Scanner data, Deloitte Center for Financial Services analysis.

Silo structure can inhibit innovation

All too often, innovation is relegated to the margins of companies—limited to an insurer's venture capital fund, innovation lab, or the domain of a chief innovation officer. Several interviewees cited a lack of connectivity among innovation entities within the line of business leaders. This can slow or even derail innovation efforts, leaving "orphan investments clogging up the system," noted one venture capitalist.

Overall, the industry's traditionally siloed structure has not been conducive to innovation. As a result, there is "little cross-pollination going on—sharing of ideas, results, learning from one another's mistakes, leveraging each other's successes to accelerate their own development," observed an innovation hub leader.

Many of those we spoke with emphasized the need for insurers to have innovation facilitators treat business unit leaders as internal clients, since they are the ones paying the bills and seeking InsurTech solutions to cope with real-world problems.

Business unit leaders usually have short-term, quantifiable benchmarks to meet for core operations. Focusing initial efforts on achieving such foundational goals can establish the effectiveness and value of those trying to facilitate greater innovation across the company. That, in turn, may earn innovation facilitators the credibility and support to develop longer-term transformational changes.

Innovation leaders often lack resources, authority

Some carriers may have thought they solved the silo challenge by appointing someone to lead and coordinate transformation efforts across the company. While chief innovation officers appeared on the insurance scene several years ago, the title and its equivalents have proliferated. Indeed, a number of those interviewed were first hires for such jobs at their respective carriers.

However, insurer innovation leaders queried often did not have much in the way of dedicated resources at their disposal or a clear mandate to do more than serve as internal consultants or information clearinghouses. Most did not have their own research and development budgets. They depend on individual business units or information technology departments for funding, competing for financing with many other investment priorities.

Compounding this problem is the general lack of incentives at most insurers to reward, if not demand, innovative thinking and results. "People do what you pay them to do, so you need to strike a balance between short-term and longer-term incentives to make sure your leaders are addressing both concerns," advised one specialty commercial insurer. "That makes innovation more of a people issue, not a technology issue. It's the challenge of change management."

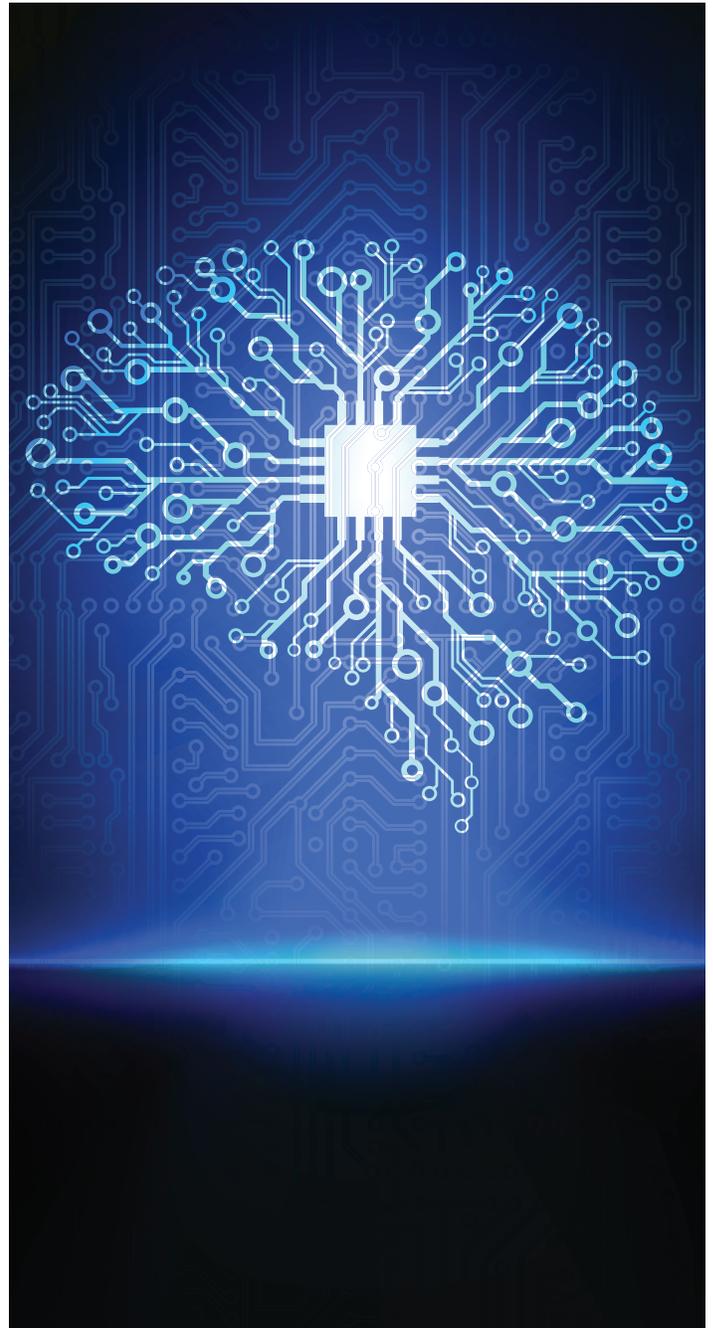
Don't forget the human element

A lack of entrepreneurial talent to spearhead and implement more ambitious innovation efforts was another key impediment cited, in terms of both skill sets and attitude toward change. Many individuals leading carrier innovation efforts are native to the industry, noted one venture capitalist, who argued that it's hard to shake up a company or a business one has served their entire career. "You're more likely to be part of the problem than part of the solution," they suggested.

A life insurer added that "few people in our industry have ever started or built something entirely from scratch. It's not in our operating DNA. As a result, the muscles we've developed to run our organization are not very helpful in seeking or achieving breakthrough innovation."

To compensate, carriers may need to import innovative thinking and skills from outside the industry. Some may choose to rely on traditional vendors or consultants to bring in new ideas based on their wider experience, rather than try to come up with innovative solutions from scratch. They might also partner with companies outside the industry to capitalize on complementary skill sets and capabilities that could accelerate innovation efforts both parties.

One option that's been underutilized is to partner with—rather than just buy products from—InsurTechs. These startups are more likely to exhibit the technological expertise, entrepreneurial spirit, and out-of-the-box thinking many insurers may lack.



More InsurTechs should be innovation partners, not vendors

InsurTech startups over the past decade have drawn \$16.5 billion⁷ in investments to spur innovation in an industry that historically has been slow to change. At first, many insurers may have considered InsurTechs a threat—perhaps even an existential one. But as we enter the second wave of the InsurTech boom, the reality is most startups have been launched to support, rather than displace, incumbent carriers.

That can be both a positive and negative development for insurer innovation. The positive is that insurers can tap into a much more diverse and entrepreneurial ecosystem for innovative ideas and solutions. The negative is that too often InsurTechs are serving incumbent carriers as any traditional tech supplier would, helping make incremental upgrades to bolster the status quo rather than working in tandem to reinvent insurance for the long term.⁸

A specialty commercial lines writer summed up an all-too-common attitude toward InsurTechs as “just a new breed of cutting-edge vendor for us—an enabler.” Although some insurers have jumped on the InsurTech investment bandwagon by forming corporate venture capital arms, relatively few are collaborating with startups in innovation. One rating agency said InsurTechs and their accelerators “still have a lot of education to do to change that supplier/customer mind set among insurers. There is so much more knowledge and skill sets to be shared.”

What’s more, InsurTechs shouldn’t be viewed as a silver bullet. Instead, carriers can start thinking about adding together the capabilities of multiple InsurTechs to solve important business challenges, such as policyholder engagement or agent enablement.

Launches stall, but investments still booming

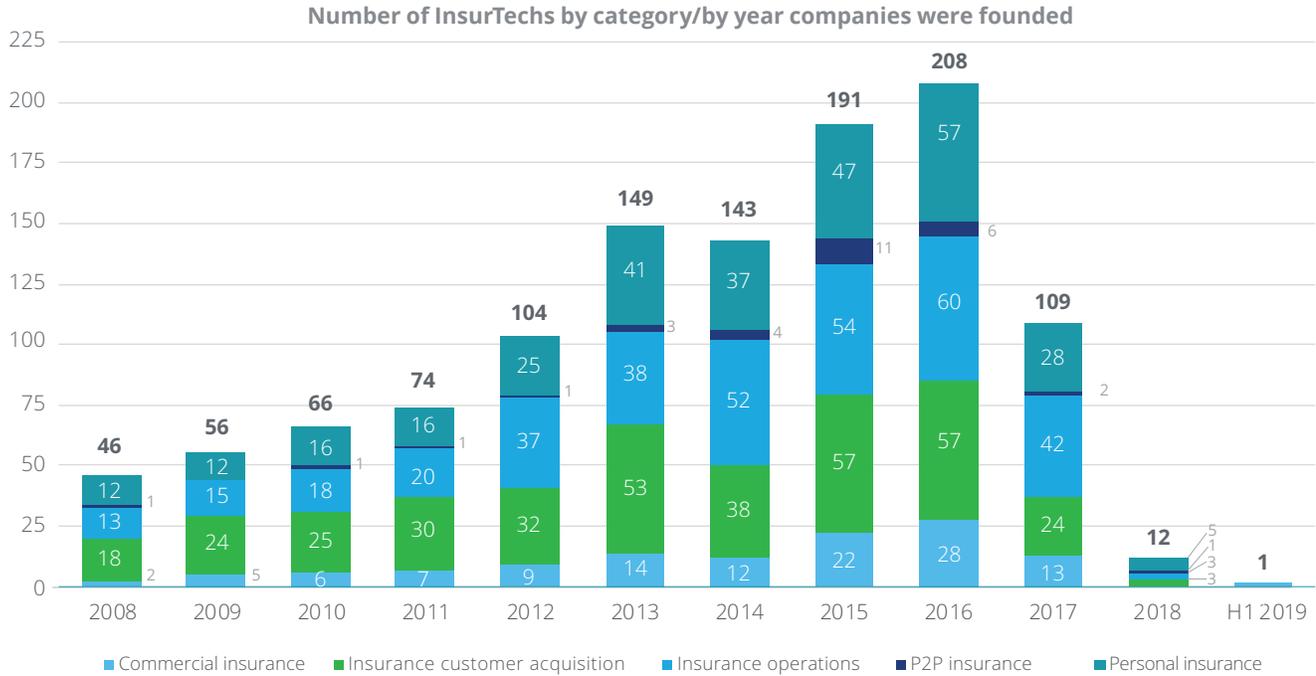
Insurers will likely need to move quickly to secure a more influential place in the maturing InsurTech development ecosystem. New InsurTech launches have dwindled to a virtual standstill over the past 18 months⁹ (see figure 2), limiting opportunities for insurers to get in on the ground floor.

However, funding remains robust as investors target later-stage financing to support those that have advanced beyond ideation to execution. The \$2.2 billion raised in the first half of 2019 is already the fourth highest amount ever, trailing last year’s total by only \$400 million. InsurTechs are on pace to eclipse 2015’s record investment of \$3 billion (see figure 3).¹⁰ Yet insurers themselves only accounted for one out of four dollars invested in InsurTechs this year, leaving most carriers on the outside looking in, no more than passive customers at best. This trend may indicate that many in the industry are adopting a more discerning approach to evaluate options for investment and deployment of InsurTech that is more readily consumable, as opposed to investing in ideas for the sake of pure R&D, which hasn’t worked all too well thus far in driving tangible innovation.

However, that doesn’t mean carriers shouldn’t be more closely engaging with InsurTechs, whether as investors or co-developers. A big roadblock is that many carriers still treat outsiders such as InsurTechs like any other software vendor and subject them to outdated contracting and onboarding standards and processes. This legacy thinking and behavior are exactly what the InsurTechs are being launched and funded to disrupt.

Figure 2. InsurTech launches bottomed out over last 18 months

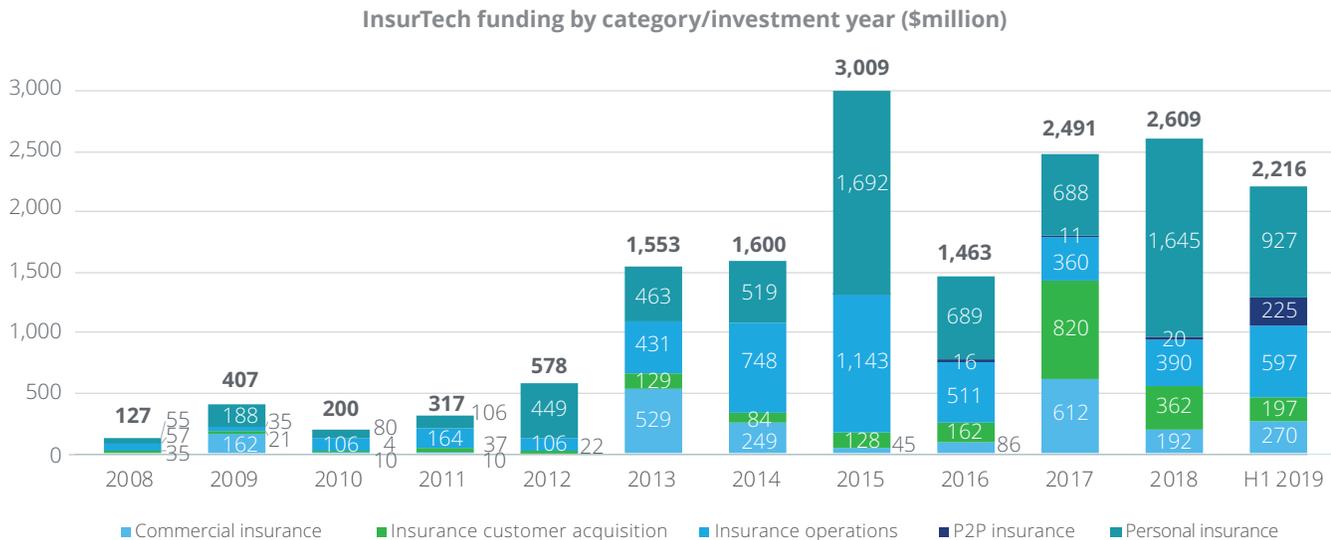
Startups reach saturation point after a decade of experimentation



Source: Venture Scanner data, Deloitte Center for Financial Services analysis.

Figure 3. InsurTech investments are on pace to be highest ever in 2019

Insurers account for only one-quarter of dollars invested in first half



Source: Venture Scanner data, Deloitte Center for Financial Services analysis.
 Note: Graphics consist of disclosed funding values only.

Rating analysts raising the bar on insurer innovation efforts

Insurers that have yet to put in place a systematic, sustainable approach to initiate, manage, implement, and measure the impact of innovation are likely to have a lot of explaining to do in the next few years to investors, stock analysts, regulators, and especially, rating agencies. One agency said while not all insurers have to be “tech trailblazers,” many still need to learn to use innovation “offensively, not just defensively to stay in the game and stand in place. Most are just trying to keep up, rather than get ahead.”

Innovation has become a major factor in the overall assessment process of the rating agencies with whom we spoke. A.M. Best, for example, is working to formalize draft criteria for quantifying the maturity level and effectiveness of insurer innovation approaches and outcomes.¹¹

In its draft, which A.M. Best released in March,¹² the agency defines innovation as “a multistage process whereby an organization transforms ideas into new or significantly improved products, processes, services, or business models that have a measurable positive impact over time and enable the organization to remain relevant and successful.”¹³

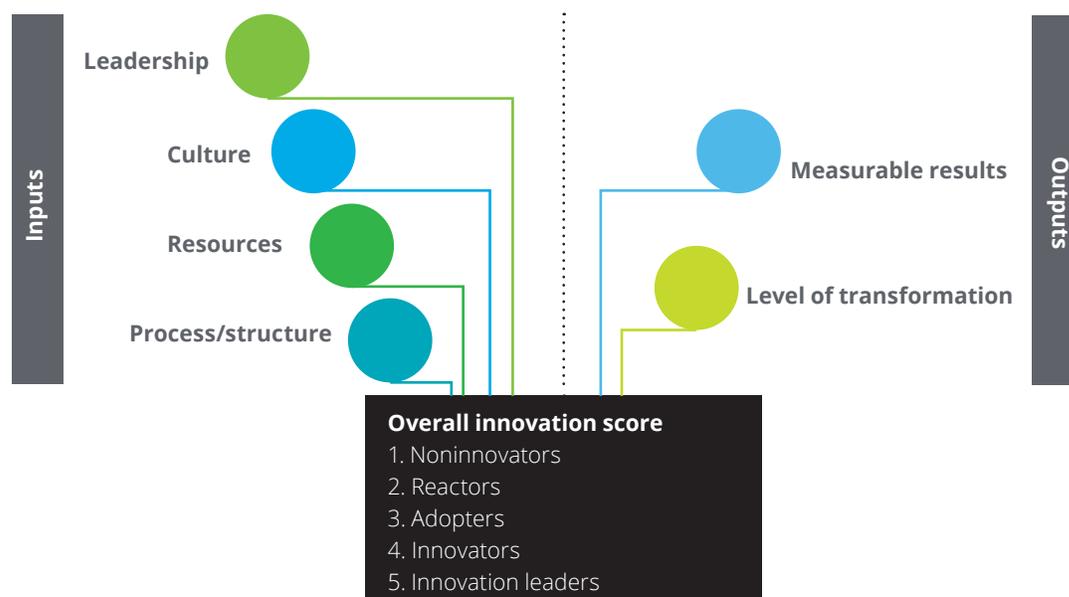
A.M. Best, which says it historically has captured innovation indirectly during its rating process, explained it intends to remain “agnostic” rather than be prescriptive about how insurers innovate. The agency will systematically assess factors contributing to innovation as well as measurable outcomes to determine how advanced insurers are on a five-level scale (see figure 4).¹⁴

A.M. Best said it is taking this step because it “anticipates the importance of innovation will increase over time and the cultivation of innovation will become a leading indicator of companies with defensible market positions,” thereby potentially affecting their financial strength.¹⁵

While the other rating agencies we interviewed are not currently considering an approach similar to Best’s, they all emphasized that innovation already ranks very high in their overall assessment criteria and will continue to grow in importance as disruption evolves in the industry.

Figure 4: A.M. Best looks to standardize innovation assessments

Rating agency will assign maturity levels in key areas and seek quantitative outcomes



Source: Deloitte Center for Financial Services graphic, based on “Best’s Methodology and Criteria, Draft: Assessing and Scoring Innovation,” A.M. Best Company, March 14, 2019.

Will rating agency scrutiny drive changes in innovation?

Most of those we interviewed agreed that demands for more information about innovation plans and outcomes from rating agencies and other outside influencers could raise the bar for insurers and prompt greater attention from company leadership.

Insurers, “while not necessarily great at innovation, are usually very good at compliance,” according to an accelerator. “If rating agency scrutiny prompts them to approach innovation in the same disciplined manner as they now handle regulatory compliance, it could focus their efforts and get the ball rolling faster and more systematically.”

A life and annuity carrier said increasing rating agency attention might indeed end up changing how insurers think about, approach, and execute innovation. “If required to get a good rating, this could gain traction,” the insurer said. “It could be a stimulus to push insurers to be more organized and agile about innovation, especially if it provides a framework to see how we stack up against peers and what we need to change to do better.”

However, the innovation head at another life insurer, while speculating that rating agency pressure might help convince leadership to allocate more resources to innovation efforts, expressed concern that carriers may end up “teaching to the test, creating more box-checking exercises.”

It’s also debatable whether the guardian inclinations typical of those working in compliance would be complementary or at odds with the generally less risk-averse attitudes of the pioneering entrepreneurs needed to drive innovation.



What might insurers do to accelerate innovation?

Reinventing an organization’s operating model and culture to expedite innovation may be a daunting prospect. Many insurers are understandably focused on making incremental fixes and upgrades necessary to maintain and bolster their aging infrastructure. Yet those we interviewed repeatedly emphasized that insurers also should start thinking and acting in a much bolder and more organized way to achieve the kind of differentiating innovation likely to be required to remain relevant, competitive, and profitable in a rapidly changing society and economy.

To get started, insurers should consider the following steps:

1. Create a business architecture that facilitates greater collaboration on sustainable innovation, both internally and externally.

Many insurers are struggling to run the business while changing the business at the same time, largely due to treating innovation on an ad hoc basis and in a siloed environment. Leadership should strongly consider rethinking their operating model to (a) incorporate more incremental innovation into helping existing business units be more effective in what they do today, while (b) making explicit investments in alternative ways to change the

company for the medium- and long-term. Both are extremely important priorities and should be treated as such, which is what we believe the rating agencies are also looking for in evaluating the effectiveness of innovation programs and impact.

Many have begun this journey by creating separate innovation units, often led by a chief innovation officer or their equivalent. Such entities need adequate staff, funding, and authority to spearhead and coordinate efforts, as well as replicate successful initiatives throughout the company. The idea is to enable the existing business to focus on core innovation while standing up a separate and distinct innovation accelerator concentrating on adjacent opportunities and transformational innovation.

Deloitte has worked with several insurers on one possible option—an innovation “speedboat” (figure 5) that can run relatively untethered to the main organization and is focused on new markets, opportunities, and growth levers. Its dedicated staff operates under a customer-centric rather than product-focused mandate and looks to spur experimentation and entrepreneurial risk-taking. It is committed to developing new operating models, customer experience alternatives, market segments, and revenue streams.

Figure 5: “Speedboat” could facilitate differentiating innovation and growth

Insurers can form a separate innovation entity to focus on and capture adjacent/transformational market opportunities and diversify a carrier’s business portfolio beyond its core through:



Source: Deloitte Consulting LLP.

2. Manage innovation expectations and incentivize experimentation with measurable goals, benchmarks, and rewards.

Many innovation initiatives likely fail not because of regulatory hurdles or legacy infrastructure limitations, but due to a misalignment of objectives. An insurance accelerator observed that most insurers launch pilots without much consideration of what the end game should be and what each stakeholder should get out of the project.

Instead, insurers should be explicitly framing the problems they are looking to solve with innovation, as well as identifying the anticipated impact and outcomes across key stakeholder groups. Setting quantifiable goals can be straightforward for initiatives upgrading the status quo: How will the investment impact the insurer's combined ratio? What will the effect be on lapse and retention ratios? What is a realistic timeline to start seeing positive returns?

But others said more pervasive innovations may require qualitative considerations: Does an innovation make it meaningfully easier to do business with customers? Is it helping improve an insurer's competitive position, or will it simply enable them to keep up? Will it differentiate them in any substantial way over the long term?

"We need an evolution in metrics to signify a demonstrated impact in these key qualitative areas," one rating agency suggested.

Metrics and associated incentives should be targeted on producing tangible results, as opposed to exploratory activity. An innovation portfolio can be established and holistically managed to understand where innovation investment is being consumed across the organization and to gauge the impact from incremental to truly disruptive changes. When conducting such exercises, we often see investments holistically over-weighted to incremental efforts, highlighting a need for greater balance across the innovation portfolio.

Such an approach can help insurers avoid getting caught up in what one specialty carrier characterized as the "theatrics" of innovation, as opposed to its tangible outcomes. "It's not about how many pilgrimages you make to Silicon Valley, gathering people in a lab, or generating a headline for doing a pilot or acquiring an InsurTech. Innovation is about strategic intent focused on long-term value creation." To reflect this mind set, the company determines up front what problems they hope to solve with an innovation project, what they expect to achieve, how they plan to achieve it, and when.

3. Learn fast and shift gears quickly.

Even though disruptive innovation could be essential to remain viable for the long term, most of those we interviewed acknowledged that pressure from leadership to "fail fast" will likely be a fact of life. How might insurers reconcile that with the need for patience in achieving long-term transformation? The innovation head of one life and annuity carrier offered a more positive alternative: "Learn fast versus fail fast is our motto."

One global multiline carrier cited the need to keep pilots from "living on as zombies for three years or more, driven by those with something invested in them."

A life insurer said successful innovation is "not so much putting time on the court as it is putting points on the board. You must demonstrate tangible progress throughout the transformation process. Are we generating new ideas and proposals that could be breakthrough innovations? Are we getting minimally viable products built and launched regularly? Are we getting quick customer feedback, and how fast are we acting on that to make course corrections?"

4. Look beyond technology to transform other essential innovation components, especially talent.

There's a danger in making technology synonymous with innovation, as many interviewees warned that tech without the right people behind it is unlikely to prepare a company to compete in a digital future.

We repeatedly heard that insurers need to recruit more entrepreneurs and put them in charge—not just of IT or even innovation, but perhaps of customer-facing business units as well. A venture capitalist looked forward to the day when an insurer hires a highly touted "name" in innovation from a global tech giant outside the industry, such as a major online retailer, search engine, social media outlet, or streaming service, to shake up the status quo.

At a minimum, innovation teams should not be solely staffed via an internal "expansion draft," with transferees from other parts of the company. One multiline insurer said they aggressively seek out talent from outside the company and the industry. The resulting mix provides experienced insights to newcomers, as well as fresh perspectives to help incumbents meet the challenges of running and changing a long-standing business at the same time.

Creating the insurers of the future

While most insurers may be understandably focused on doing what they already do, only faster and cheaper, longer-term competitive threats are looming that will likely require far more differentiating innovation down the road. Traditional silos between personal and commercial lines are cracking in the face of changing customer behavior and needs. Digitization is putting pressure on all industries to customize products and services and make them available on demand, in real time, over multiple platforms.

Incremental innovations to maintain status quo systems, distribution options, and business models are not likely to suffice in the face of such dramatic changes in society and the economy. Fundamentally changing how insurers operate and provide value is becoming a

make-or-break necessity. That means most insurers can no longer afford to merely dabble in innovation. They should be reimagining their value proposition to serve consumers for a very different future and start taking more substantial steps to get there before others beat them to the punch, whether from within or outside the industry.

Insurers are not victims of circumstance, or at least don't have to be. They still have time to raise their game through innovation and disrupt themselves before others disrupt or even displace them.

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