# 2014 Insurance Industry Outlook Survey

## Revolution, not evolution

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2014 Insurance Industry Outlook Survey 1

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# FOREWORD

The insurance industry faces a potential upheaval that could challenge incumbents and remake the industry in a new form. To win in the marketplace, companies need to think in terms of revolution, not evolution.

That was our thinking when, in the second quarter of 2014, KPMG surveyed 95 senior insurance executives in the United States to obtain a clear and up-to-date view of the industry. What we to learned was this: evolution—not revolution—is happening—and that evolution has only just begun.

Here we offer specifics of our research, as well as considerations for moving forward. We hope you find this report illuminating and that we will have the opportunity to discuss our findings with you in the near future.

Laura

**Laura J. Hay**
National Sector Leader, Insurance
KPMG LLP

Laura Hay, KPMG's U.S. Insurance leader and board member, has more than 28 years of professional experience in the insurance industry, particularly in financial statement conversions (U.S. GAAP, IFRS), Solvency II and enterprise risk management, integrating risk and performance management, and model-related services. In 2012, she was named to *Consulting Magazine's* Women Leaders In Consulting list. Laura also finds time to coach the Rivertowns Utd B03 Galaxy, a youth soccer travel team in Westchester County.

## REVOLUTION, NOT EVOLUTION

**A number of fundamentals promise to force drastic changes in the insurance industry. A growing middle class in emerging markets is clamoring for products tailored to its needs. Catastrophic weather events are forcing P&C carriers to rethink risks. Retirees need annuity and financial management services, given the real risk of outliving their assets. Customers everywhere want to use smartphones and the Internet to shop for insurance. Driverless cars are already on the roads. And low-cost, tech-enabled producers are taking market share from established players, who continue to struggle with legacy systems.**

According to our survey, responding to these fundamentals is a priority for insurance executives, but it is not the top priority. Collectively, the industry is focused on taking care of the business it already has, which includes dealing with a flood of new regulations.

Over and over—in their views on growth drivers, planned investment, M&A, talent, operations, enterprise risk management (ERM), and data analytics—respondents revealed their awareness that a next-generation insurance industry is coming, with customer centricity, new products, and new distribution channels, all enabled by new technology and tech-savvy talent, but they also revealed their unwillingness or inability to implement that change now.

In other words, the executives say they want evolution, not revolution. For now, they are focused on nurturing their existing business models while strategizing about new ones, navigating shifting capital requirements worldwide, and using M&A primarily to access new markets and geographies.

We firmly believe that those companies that defy the collective opinion of the industry will give themselves a clear competitive advantage. It all comes down to the pace of change. Evolution in this environment is too slow. Revolutionary steps are needed. We offer "10 Steps to Revolution" to help you get started.

*"If there were ever a time for top-down leadership to drive change, now would be it."*

**Laura J. Hay**
National Sector Leader, Insurance
KPMG LLP

# 10 STEPS TO REVOLUTION

The insurance industry as a whole is engaged in *evolutionary* change. Companies that take *revolutionary* actions now will be the winners in the new insurance marketplace. Here is where to start:

## STRATEGIC REFOCUS

1. Evaluate product mix based on customer focus, profitability, and capital usage
2. Incorporate technology strategy into refocusing sessions
3. Consider M&A to gain new markets, talent, products, customers, technology, data analytics capability, and effective regulatory capital management

## CUSTOMER "FRONT AND CENTER"

4. Use data analytics and social networking to gain an understanding of customer needs and develop products and pricing to meet those needs
5. Design, develop, and deliver engaging, seamless customer experiences across traditional, digital, social, and mobile delivery channels
6. Measure customer experiences and make course corrections and improvements based on scores (see KPMG International's "Customer Experience Barometer"[1])

## REGULATIONS

7. Build a flexible and agile infrastructure—including technology and workforce—to respond to increasing regulatory volume and uncertainty

## TALENT

8. Attract, train, and retain the right talent to help build a customer-focused, data-driven business model

## DATA AND KNOWLEDGE

9. Build a data analytics capability to facilitate sophisticated predictive analytics for underwriting, pricing, customer acquisition and experience, claims management, ERM, and fraud prevention

## INFRASTRUCTURE

10. Tackle IT legacy issues to facilitate migration to a customer-focused, data-driven business model

[1] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/customer-experience-barometer/Documents/customer-experience-barometer-v1-fs.pdf

## SURVEY HIGHLIGHTS

**Biggest threats to business models**
are new regulations/legislation (34 percent) and losing share to lower-cost producers (31 percent).

**Top three transformation drivers**
over next three to five years are customer demand (52 percent), coping with change in technology (45 percent), and domestic competition (42 percent).

**M&A activity is heating up**
over the next 12 months, with the majority of companies (54 percent) likely to be involved in M&A as a buyer, up from last year (34 percent).

**Strategic acquisitions are the highest priority investment**
over the next 12 months (34 percent, up from 22 percent in 2013).

**Customer growth/service and data analytics**
at 27 percent and 26 percent, respectively, are the highest priority *technology* investment areas.

**Investment in talent is up**
as a high priority investment over the next 12 months, jumping from 2 percent in 2013 to 24 percent in 2014.

**Investment in organic growth is top initiative**
expected to consume senior management's time, energy, and resources (19 percent).

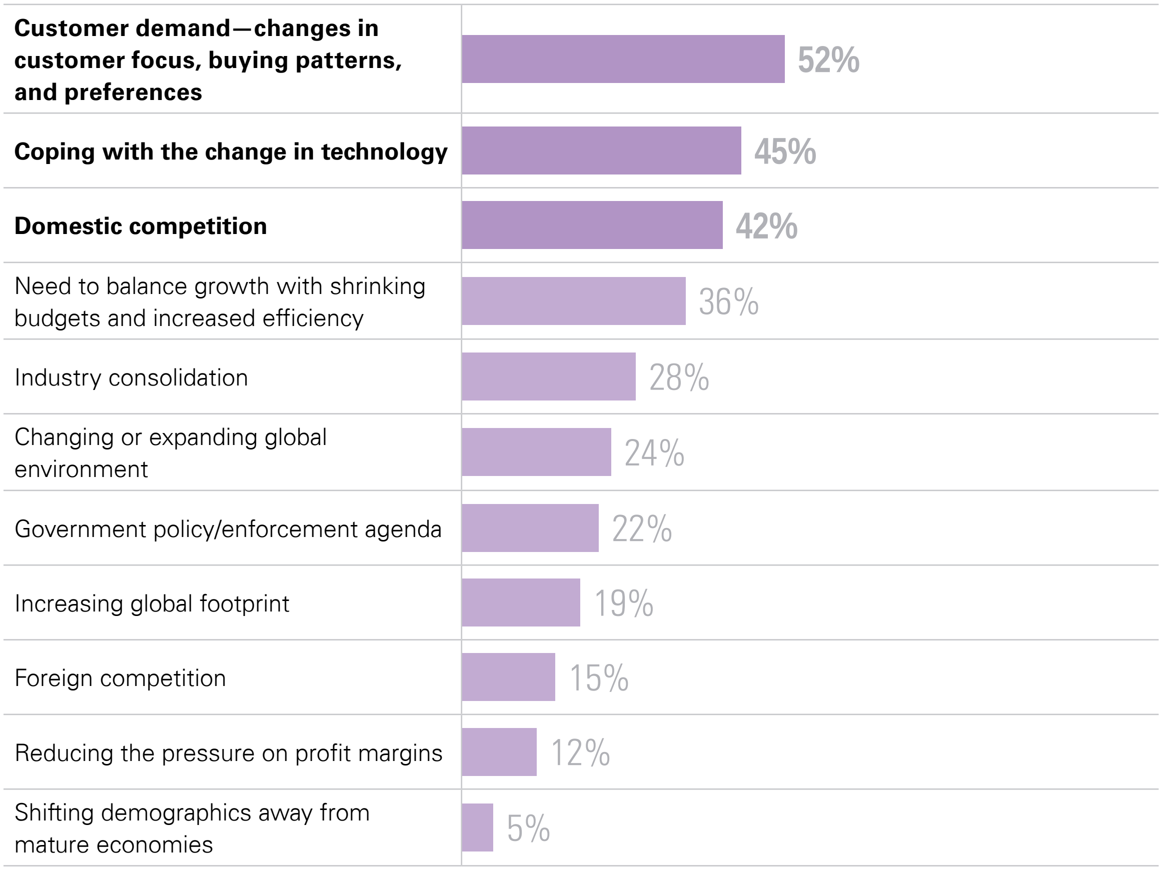
**Underwriting/pricing/distribution channels**
are the focus of planned operational improvements (43 percent, up from 40 percent in 2013).

THE NEED FOR REVOLUTION

## Driving transformation

According to the insurance executives we surveyed, the top three "drivers of transformation" over the next three to five years are customer demand (52 percent), coping with change in technology (45 percent), and domestic competition (42 percent).

Q: Over the next three to five years, what will be the top three drivers of transformation for your business?




*(Multiple responses allowed.)*

## Threats to business models

When asked to identify the biggest threats to their business models, more executives cited the impact of new regulations and legislation (34 percent) than any other threat. "Losing share to lower-cost producers" was cited by 31 percent of respondents.

Q: What issues pose the biggest threat to your business model?

| Issue | 2014 | 2013 |
|---|---|---|
| Impact of new regulations/ legislation* | 34% | |
| Losing share to lower-cost producers | 31% | 32% |
| Speed/magnitude of economic recovery* | 23% | |
| Lack of job growth* | 18 | |
| Cyber threats (e.g., hacking, data breaches)* | 17 | |
| Disruptive technologies | 11 | 7 |
| Energy costs | 8 | 5 |
| Lack of qualified workforce | 8 | 10 |
| Inability to find visionary leadership | 7 | 9 |
| Customer/employee mobility | 7 | 14 |
| Other | 2 | 3 |
| Inability to find capital | 1 | 5 |
| Political/regulatory uncertainty** | | 58 |

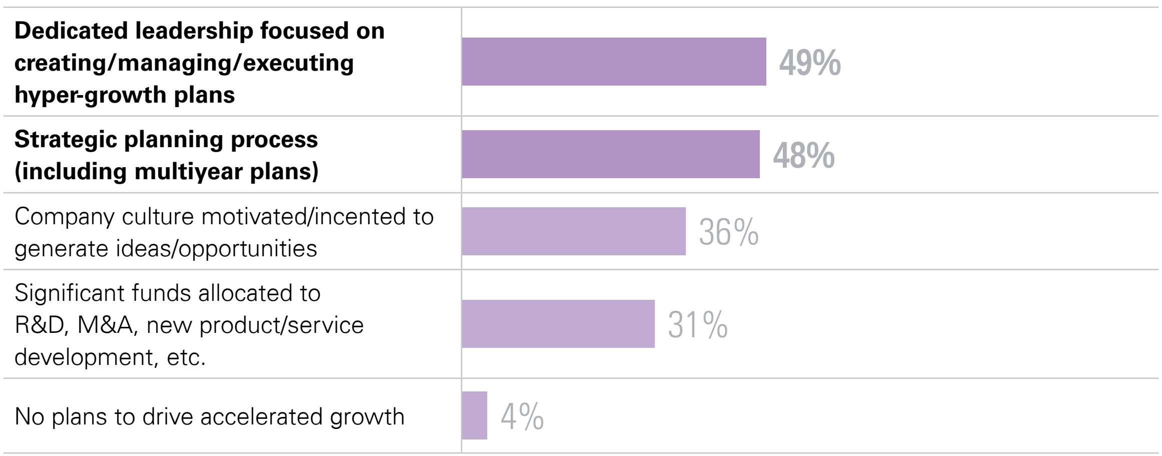
*(Multiple responses allowed.)*

***Not asked in 2014*
**Not asked in 2013*

## Process deployment

The processes and resources most deployed by insurance companies over the next three to five years, according to executives, will be a "dedicated leadership focused on creating/managing/executing hyper-growth plans: (49 percent) and a strategic planning process (48 percent).

Q: In an effort to drive accelerated growth over the next 3–5 years, what processes/resources is your company deploying?




*(Multiple responses allowed.)*

Executives' responses to our "transformation" question paint a clear picture of the environment they are operating in: burgeoning customer demand combined with intense competition from next-generation companies that leverage technology to reach their customers and manage their risks.

Customer demand is growing exponentially worldwide, fueled by fundamental worldwide change—catastrophic weather events, changing demographics, a transforming auto industry, and a growing middle class in emerging markets, as well as new modes of shopping. Companies are under pressure to create viable products that meet the needs of this huge potential market and also to find ways to interact with customers.

Technology will be one of the key engines of change, providing knowledge of customers through data analytics and customer interfaces through social media, smartphone technology, and other channels. It can enable companies to better manage complex and varying regulatory requirements worldwide and it can provide the actuarial and statistical underpinnings of new products, pricing, and risk management.

Low-cost producers, many of whom do not have to contend with rebuilding legacy systems or reinventing business models, are entering the domestic market with new products and new ways to engage with customers. These producers provide a glimpse of how the next-generation insurance industry will operate. Nevertheless, losing market share to these producers ranks as only a secondary threat to business models, according to executives. Their primary threat is the impact of new regulations and legislation, which consist largely of multiple capital requirements (35 percent) and changes to the insurance contracts standards (31 percent). Regulatory issues, along with recouping losses during the downturn, may be enough challenge for the industry to deal with in the short term.

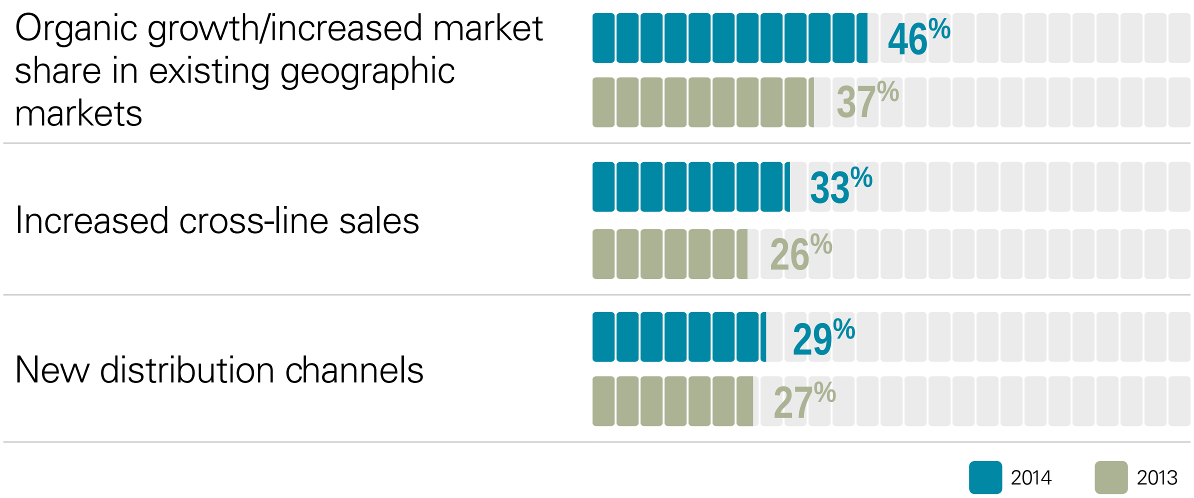
**KPMG analysis:** In terms of strategic planning, companies do appear to have an eye on the future. "If there were ever a time for top-down leadership to drive change, now would be it," says Laura Hay. "The findings suggests that companies are applying 'dedicated leadership' to conceptualize how they will move forward."

# YOU SAY YOU WANT EVOLUTION: **GROWTH**

## Drivers of growth

Almost half of executives said that the biggest driver of revenue growth in the next one to three years would be organic growth and increased market share in existing geographic markets (46 percent, up from 37 percent last year). Increased cross-line sales was cited by 33 percent of executives. New distribution channels and introduction of new products were cited by only 29 percent and 18 percent of executives respectively, the latter down from 39 percent in 2013.

Q: Which of the following areas do you believe will be the biggest drivers of your company's revenue growth in the next one to three years?




*(Multiple responses allowed.)*

**KPMG analysis:** Insurance executives are telling us that they need to focus on top-line growth—selling their bread and butter products, while trying to cross-sell to the same customers. We could not agree more. Last year's revenue jump resulted from the growth of the stock market, but top-line growth was flat. The industry risks flat top-line revenue in 2014 as well. Companies simply have to do better at their core business.

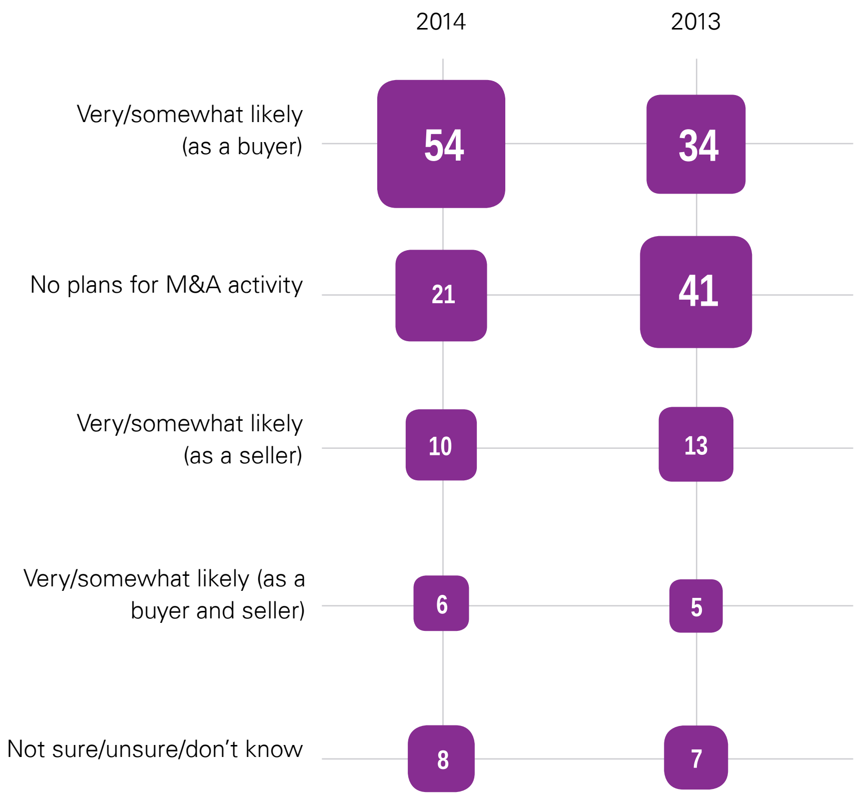
One of the ways they can sell more products to more customers is through better distribution channels—which executives recognize. However, the fact that "new distribution channels" ranks only third as a revenue driver (and "introduction of new products" ranks a distant eighth) means the evolutionaries are firmly in charge.

YOU SAY YOU WANT EVOLUTION: **M&A**

## M&A activity heats up

Over the next 12 months, a majority of the executives surveyed (54 percent) believe their company is likely to be involved in M&A as a buyer, up from last year (34 percent). In addition, the number of executives who say they have no plans for M&A activity dropped from 41 percent in 2013 to 21 percent this year.

Q: What is the likelihood that your firm will be in a merger/acquisition over the next 12 months?




*(May not equal 100% due to rounding.)*

## Investment priorities

Strategic acquisitions is the highest priority investment area within the next 12 months (34 percent, up from 22 percent in 2013). Marketing and customer programs (25 percent) and resources/strategic talent (24 percent) are secondary priorities, though "talent" has jumped drastically in importance since last year (2 percent).

Q: To the extent that your company has excess capital to invest within the next 12 months, what is the highest-priority investment area for the company?

| | **% in 2014** | % in 2013 |
|---|---|---|
| Strategic acquisition | 34 | 22 |
| Marketing/customer programs | 25 | 23 |
| Information technology* | 24 | N/A |
| Resources/strategic talent | 24 | 2 |
| Stock repurchase | 20 | 8 |
| Geographic expansion* | 20 | N/A |
| New products/services* | 15 | N/A |
| Increased dividends | 12 | 8 |

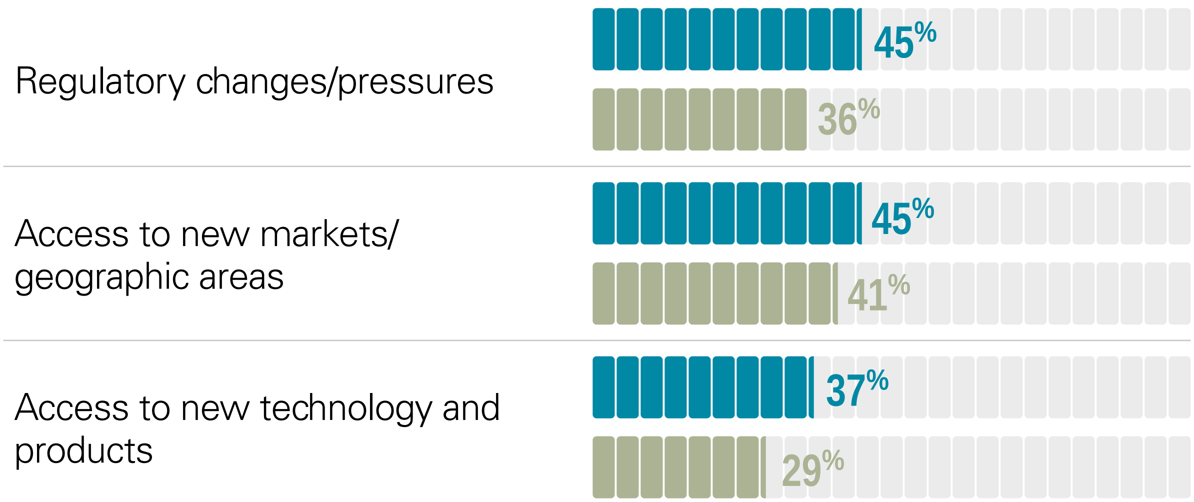
*(Multiple responses allowed.)*

**Not asked in 2013*

## M&A drivers

The top M&A drivers remain the same compared to last year, with almost half of respondents citing access to new markets/geographic areas (45 percent) and regulatory changes/pressures (45 percent). Access to new technology and products was cited by 37 percent of respondents.

Q: Which of the following do you think will be the most important drivers of alliances, mergers, and acquisitions in the industry over the next 12 months?




| | 2014 / 2013 |
|---|---|
| Improved use of capital | 24 / 23 |
| Product synergies | 15 / 29 |
| Strategic divestiture of current assets | 13 / 14 |
| Access to new resources | 11 / 18 |
| Other | 1 / 3 |

2014 2013

*(Multiple responses allowed.)*

Insurance M&A has shown a significant increase since last year as many life companies have sold off low-performing businesses, in many cases to foreign entrants into U.S. markets. Since the end of the recession, large life transactions have already occurred; in the P&C segment, transactions are just starting to pick up and the larger consolidations will occur during the coming year.

Coming out of the recession, many companies are holding a significant amount of capital, which they can either return to investors or use to build out their business. On the life side, most M&A is being used to acquire investment management capabilities to meet the needs of baby boomer retirees. Investors are more optimistic about the strength of the economy and about the strategic refocusing of the industry, so companies are under pressure from shareholders to focus on their core businesses.

The focus on the core business ties in with the regulatory driver of M&A. According to "Ten Predictions for Growth: Trends shaping the future insurance M&A landscape", a paper by KPMG International, "The continuing implementation of risk based capital and consumer protection initiatives will serve as a catalyst for change, creating investment opportunities. Specific initiatives like the Asset

Quality Review for the banking sector will result in a more rigorous assessment of whether insurance business are considered core or could be sold."[2]

In any case, the regulatory impact on M&A can best be described as a global conversation. For example, some European insurers may divest their U.S. business because of capital requirements back home. Other countries, such as China, India, and some Latin American countries, which do not have enough capacity to meet the needs of retirees, are relaxing barriers to encourage foreign investment.

The evolutionary theme rings true in M&A, given its current dominant drivers. Overall, companies are using M&A to bring traditional products—or at least, a traditional way of doing business—to new markets and geographies and to respond to new regulations. New and better use of technology, which promises to be the underpinning of a new way of doing business, is, for the moment, a secondary driver.

Only for the reinsurance segment was technology a key factor (39 percent); this is particularly significant because reinsurance companies were much more likely to be involved in M&A as buyers (70 percent) than any other segment (38–55 percent). Reinsurance companies depend on sophisticated data analytics for their underwriting capability.[3] Life companies do also, but this segment tends to outsource back offices because of the extreme complexity of the analytic requirements.

**KPMG analysis:** "Step change in the use of technology is coming," according to the KPMG International "Ten Predictions" paper. "High growth markets, without constraints of legacy products and infrastructure, could lead the charge, particularly by leveraging mobile technology and expanding upon the success of telematics[4].... Investment opportunities will be created through partnerships, joint ventures and acquisition of innovators by traditional players." And further, on data analytics: "Another step change for the industry [will occur] as partnerships are established to capitalize on data driven business models (e.g. Google, Amazon, Apple, retailers) resulting in a fundamental change in the way insurance is bought and sold. Traditional incumbents must react."[5]

However, if our survey results are any indication, sea-change in technology transformation will have to wait. As KPMG partner Ram Menon observes, "Senior management that has been around for 20 or 30 years understand that a huge capital investment in technology will be required, but many may be reluctant to do it on their watch."

*"Senior management that has been around for 20 or 30 years understand that a huge capital investment in technology will be required, but many may be reluctant to do it on their watch."*

**Ram Menon**
National Leader – Insurance
Transactions & Restructuring

[2] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/insurance-ma-landscape/Documents/insurance-ma-landscape-v2.pdf

[3] http://www.propertycasualty360.com/2014/02/28/technology-in-reinsurance-more-than-just-a-helping

[4] Telematics is an interdisciplinary field encompassing telecommunications, vehicular technologies, road transportation, road safety, electrical engineering (sensors, instrumentation, wireless communication, etc.), and computer science (multimedia, Internet, etc.)

[5] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/insurance-ma-landscape/Documents/insurance-ma-landscape-v2.pdf

## YOU SAY YOU WANT EVOLUTION: DATA AND ANALYTICS

### Investing in technology

The highest-priority technology investments, according to executives, are customer growth and service (27 percent), data/predictive analytics (26 percent), and risk modeling and analysis (24 percent).

Q: Looking at technology investment, which of the following are the highest-priority investment areas for your company ***over the next two years***?

27% **Customer growth/service**
2013: 32%

26% **Data/predictive analytics**
2013: 33%

24% **Risk modeling and analysis**
2013: 26%

21% **IT Infrastructure**
2013: 43%

19% **Mobile technology***

18% **Business intelligence (BI)/reporting***

16% **Financial (accounting, general ledger) systems (new, upgrade, consolidation)***

13% **Cloud computing**
2013: 20%

12% **Enhanced security and information protection***

11% **Forecasting capabilities**
2013: 14%

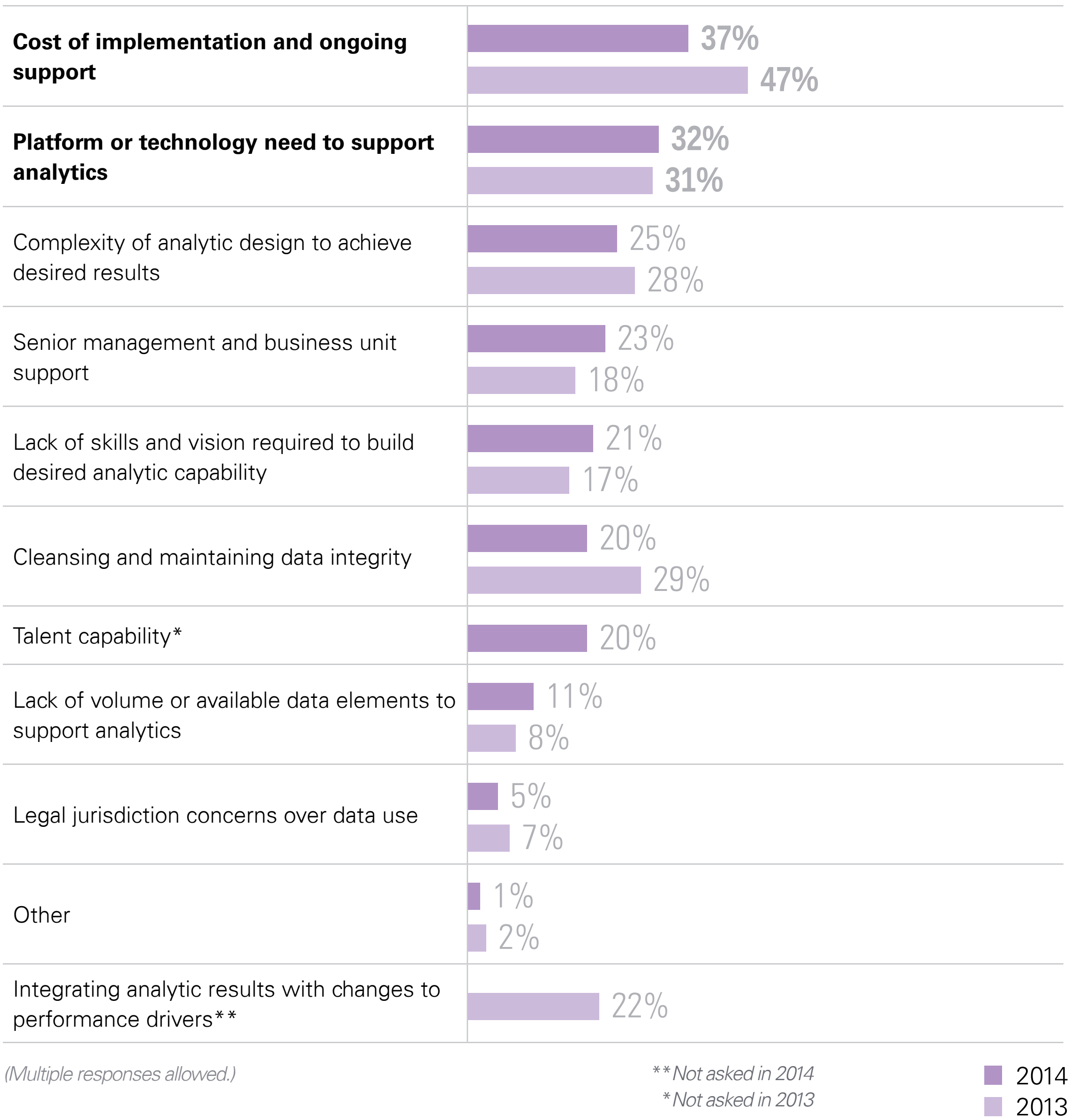
*Not asked in 2013*

*(Multiple responses allowed.)*

## Implementing data analytics

The executives reported that the most significant data analytics challenge is cost of implementation and ongoing support (37 percent), down by 10 percentage points since 2013 (47 percent).

Q: What do you perceive to be the biggest challenges to implementing more sophisticated data analytics?

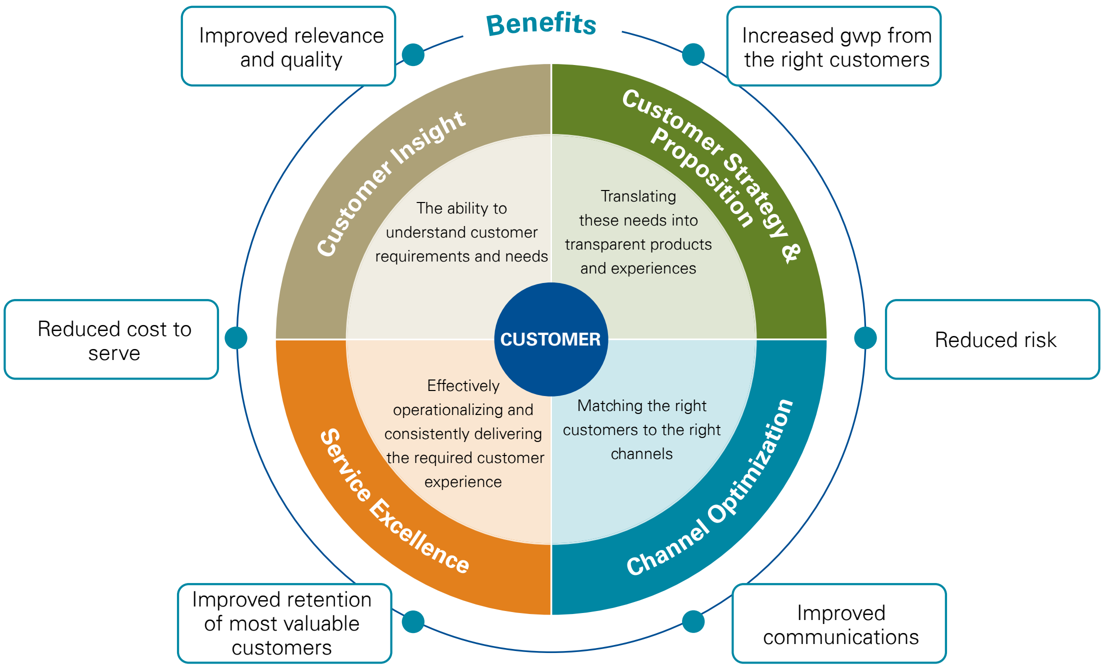



*(Multiple responses allowed.)*

***Not asked in 2014*

**Not asked in 2013*

## The customer-centric organization




*Source: KPMG LLP*

**KPMG analysis:** By targeting customers as the primary focus of technology investment, but relegating two important enablers of customer centricity—data/predictive analytics and risk modeling/analysis—to second and third place, executives convey a decisively forward-looking—but nevertheless, evolutionary—mindset. They are thinking strategically, but not ready to act tactically.

On the other hand, these rankings are separated by no more than three percentage points. Executives are saying that it is time for customers to be the drivers of new technology investments, wherever that leads. What is more, they have identified two specific initiatives that deserve their investment at some point.

Interestingly, the votes for overall IT infrastructure, which totaled 43 percent last year, fell dramatically this year to 21 percent. Since companies are still burdened by legacy systems, this can only mean a shift from thinking about technology as enterprise architecture to technology as an enabler of customer focus through including data analytics.

The above chart is one way to show what the customer-centric organization looks like and how it is enabled by data analytics. Data analytics can enable increased revenue from the right customers, reduced risk by matching the right products to the right customers, improved communications with customers, improved retention of the most valuable customers, reduced cost to serve customers, and improved relevance and quality of products.

*"It is precisely the factors that challenge you as a customer that are creating unprecedented opportunities for the Insurer of the Future. Namely, an overwhelming access to information and insight that is morphing real-time."*

**Tracey Ah Hee**
Managing Director, KPMG LLP – Customer Experience, Customer Strategy & Growth

## The customer experience barometer

"For financial institutions and other service-based organizations, success will hinge on the customer experience," says KPMG's Global Chair, Financial Services Jeremy Anderson.[6] "That's why insurance companies need to develop tools to measure, track, and benchmark customer experience across brands, sectors, and markets. One such tool, KPMG's Customer Experience Barometer, tracks 30 criteria and aligns investment levels to the importance of each criterion."[7]

| | | |
|---|---|---|
| **1** | **Accessibility** | • The choices/options available for contacting a provider<br>• The physical proximity/ease of access of a company<br>• Availability of services (around the clock)<br>• The appearance and operation of a Web site (including navigation)<br>• The ambience or decor of a bank, office, store |
| **2** | **Ease of doing business** | • Having services and products that are easy to understand<br>• Ease of getting issues/queries/complaints resolved<br>• Ability to get in contact with the company with short wait times |
| **3** | **Executional excellence** | • Speed of making an inquiry/transaction<br>• Getting things right the first time<br>• Consistency of service—continuity in communications or interactions<br>• Speed when resolving a complaint/resolving a query<br>• Speed of service |
| **4** | **Personalized offering** | • Rewards my loyalty<br>• Offers products and services that can be tailored to my specific needs<br>• Rewards my choice to do business with the company |
| **5** | **Staff engagement** | • Staff who consistently follow through on their promises<br>• Staff with a positive attitude<br>• Staff who are knowledgeable<br>• Quality of advice and service offered<br>• Staff who are honest and tell the truth |
| **6** | **Value for money** | • Value for money (i.e., fair and appropriate fees and charges)<br>• Availability of rewards and promotions |
| **7** | **Brand value and reputation** | • A brand that inspires me<br>• A company that is well regarded in the media<br>• A company I know will deliver<br>• A company that puts the consumer first<br>• Trust in the brand to do the right thing<br>• Trust that the brand understands my needs<br>• Trust that the brand delivers on its promises |

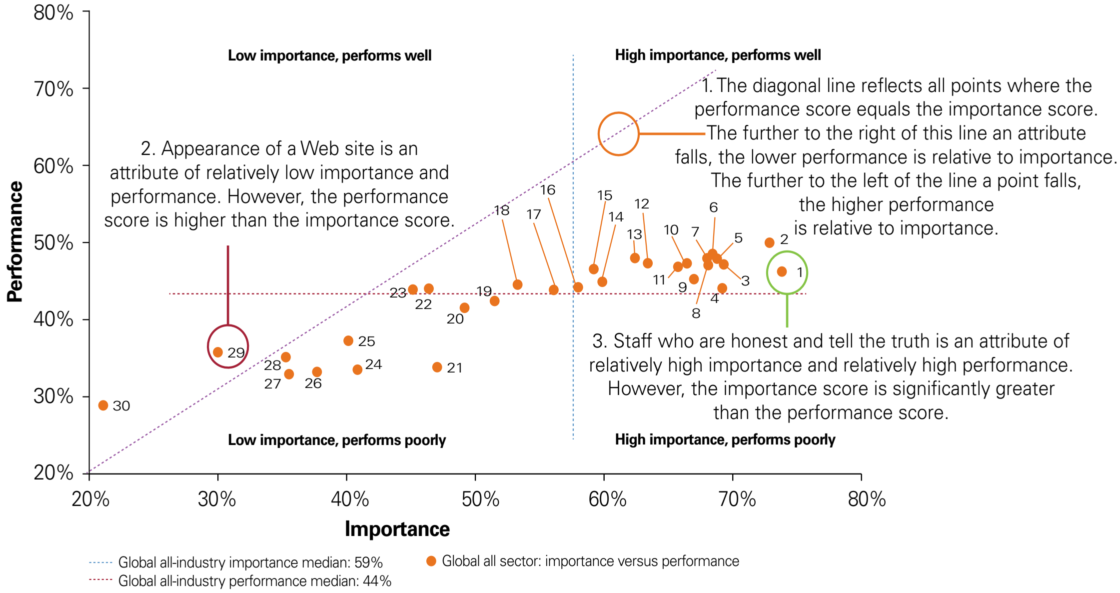
*Source: Customer Experience Barometer, KPMG International, 2014*

[6] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/customer-experience-barometer/Documents/customer-experience-barometer-v1-fs.pdf

[7] Ibid

## An illustration of importance versus performance

Insurance companies that want to make the transition from evolution to revolution will benefit from tools such as the scatter diagram shown below, which is used to apply the data to improvements in their business model.




*Source: Customer Experience Barometer, KPMG International, 2014*

A scatter diagram shows the relationship between the importance and performance of attributes, where the performance gap is represented by the distance a point falls from the diagonal line that represents a performance score equal to an importance score. In addition to measuring customer experience across the model, it measures other customer indicators commonly linked to economic value, such as customer advocacy, customer loyalty, the likelihood of a customer to purchase again, and the treatment of customer complaints.

## Driverless cars run on data

The market of the present is ready for providers that can focus on the customer with the help of data analytics. In the market of the future, organizations that are not data driven will simply cease to exist. The driverless car insurance market is a case in point.

According to KPMG's Leslie Fenton, "The technology backing [driverless car] developments has the potential to not only reshape the auto industry, but the insurance sector as well." U.S. Department of Transportation mandated vehicle-to-vehicle communication technology will allow vehicles to exchange basic driving diagnostic data (e.g., speed, braking, distance, etc.) with one another. "For insurers that offer auto coverage based on these and other factors, access to this treasure trove of information has the potential to turn their business models upside down," she writes. "Many insurers are keen on securing access to, or better yet owning, the data to keep their current insurance products competitive and potentially introduce new ones. This may take a variety of forms, whether it is acquiring a company in the data technology space or forming an alliance with an OEM, automotive supplier, or technology firm."[8] Clearly, companies that eschew data analytics approaches will be left out of the auto insurance market.

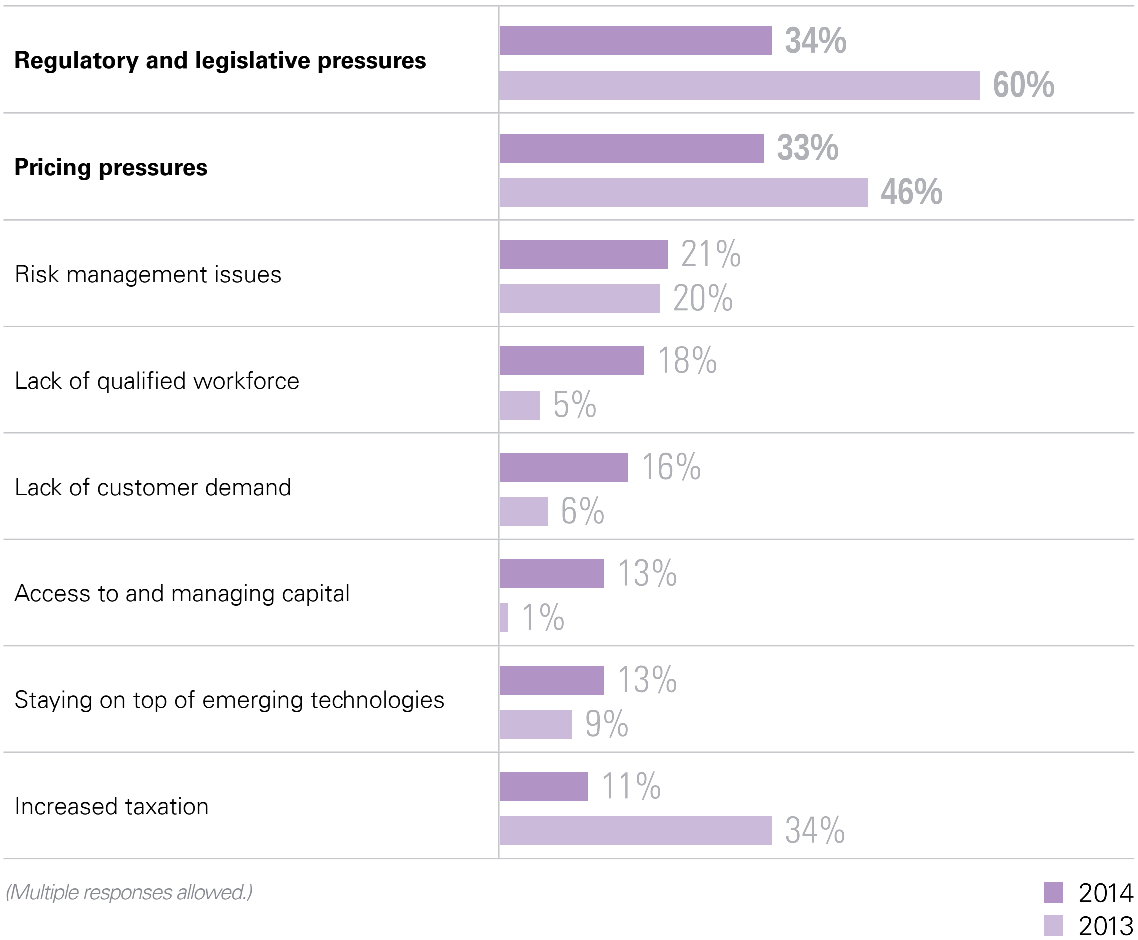
[8] http://pitchbook.com/Daily_Newsletter.html?nid=KHC3TG3S3KER4

# YOU SAY YOU WANT EVOLUTION: **TALENT**

## Barriers to growth

In keeping with other indicators, the top significant growth barrier for companies during the next 12 months is legislative and regulatory pressures (34 percent), though this is significantly down from 2013 (60 percent). Lack of qualified workforce ranks a distant fourth (18 percent), though significantly up from last year (5 percent).

Q. Which of the following are the most significant growth barriers facing your company over the next 12 months?




*(Multiple responses allowed.)*

## Focus on talent

Insurance companies' primary focus within talent management over the next 12–24 months will be development/training (up to 52 percent from 31 percent last year). Retention, the leading focus last year, is now second in line (46 percent in 2014, 41 percent in 2013). Acquisition/recruiting (34 percent) almost doubled from last year (18 percent).

Q: What are your key areas of focus with respect to talent management in the next 12 to 24 months?

| | **% in 2014** | % in 2013 |
|---|---|---|
| Development/training | 52 | 31 |
| Retention | 46 | 41 |
| Performance management | 34 | 31 |
| Acquisition/recruiting | 34 | 18 |
| Succession planning | 22 | 32 |
| Rewards/compensation | 19 | 32 |
| Diversity | 12 | 16 |
| Global talent management/workforce planning | 6 | 13 |
| Engagement/communication | 4 | 25 |
| Other | 0 | 1 |

*(Multiple responses allowed.)*

*"There is no single pattern for reinvention right now. Companies are all over the place. But you have to start somewhere."*

**Laura J. Hay**
National Sector Leader, Insurance
KPMG LLP

It is widely known that the insurance industry has difficulty attracting new talent, and that this is in part because it is one of the least tech-savvy industries, which does not play well with younger job seekers. As one commentator put it, "… just when pursuing leading-edge solutions is no longer discretionary for insurers, it may be harder than ever to attract the 'best and brightest' to the business."[9] In addition, financial services companies as a whole have been struggling to attract Gen Y applicants, who are looking for more balanced lifestyles.[10] For example, according to the *Wall Street Journal*, tech companies overtook financial services for the first time in 2013 at Stanford Business School, "with 32% of the class accepting tech jobs and just 26% heading into finance. Two years ago, those figures were 13% and 36%, respectively."[11]

Among our survey respondents, talent is an issue, but it is clearly not the most pressing issue. For one thing, only 18 percent of executives consider the lack of qualified workforce a barrier to growth, the fourth ranked barrier on the list, suggesting that the industry is focused more on near-term growth following the recession than financial transformation. That transformation will depend on inputs from Gen Y graduates who are at ease with all things IT.

Likewise, when it comes to data analytics, executives see cost (37 percent) and platform technology (32 percent) as the biggest challenges in that arena, not talent issues, even though three separate, highly ranked challenges are talent-related: complexity of analytic design (25 percent), lack of skills and vision required to build desired analytic capability (21 percent), and talent capability (20 percent).

Of all the segments, only reinsurance appears to be putting talent on the top of its lists of concerns. Talent is the highest priority investment area for reinsurance companies over the next 12 months (35 percent), which dovetails with this segment's eagerness to acquire (through M&A) the new technology that young employees seek. For the life segment, strategic acquisitions is the high priority investment area (45 percent). For P&C, it is marketing/customer programs and information technology (in addition to strategic acquisitions), which begs the question, who will provide the necessary capabilities and skills to go along with these investments?

**KPMG analysis:** For some companies, talent may be the starting point for reinventing their business model. "There is no single pattern for reinvention right now. Companies are all over the place. But you have to start somewhere," notes Laura Hay.

For example, AIG is starting by moving 4,000 staff to lower-cost cities by 2015, as a prerequisite for introducing a new claims management system and using additional data in underwriting decisions. "AIG is making progress fixing what was broken, and in time the company will benefit from the radical simplification of its legacy infrastructure."[12]

Indeed, our own respondents provide evidence of an in-with-the-new mentality when it comes to talent and resources—specifically, the spike in development training, along with the emphasis in recruiting over retention.

[9] http://www.insurancetech.com/management-strategies/how-insurance-companies-can-attract-top/240001955

[10] http://www.workforcecyprus.com/news.php?id=29

[11] http://online.wsj.com/news/articles/SB10001424052702303661404579180152676790032

[12] http://www.insurancejournal.com/news/national/2014/05/29/330320.htm

# YOU SAY YOU WANT EVOLUTION: **OPERATIONS AND ERM**

## On the minds of management

Among the top three initiatives expected to consume the senior management's time, energy, and resources, operation processes and related technology (14 percent) take a back seat to investment in organic growth (19 percent) and regulatory changes (17 percent). This order of priorities remains roughly the same as last year.

Q. Over the next 12 months, what initiative will consume most of senior management's time and energy?

| | 2014 | 2013 |
|---|---|---|
| Significant investment in organic growth (new product development, pricing strategies, geographic expansion) | 19% | 16% |
| Staying ahead of or navigating significant changes in the regulatory environment | 17% | 18% |
| Strategic divestiture of current assets | 14% | 3% |

| | 2014 | 2013 |
|---|---|---|
| Significant improvement of operation processes and related technology | 14 | 14 |
| Significant changes in business model | 9 | 13 |
| Entering into new markets | 8 | 9 |
| Merger/acquisition | 7 | 5 |
| Improve enterprise risk management programs/processes | 4 | 6 |
| Significant changes to financial processes and related technology | 3 | 3 |
| Other | 2 | 0 |
| Significant cost reduction initiatives | 2 | 13 |

*May not equal 100% due to rounding*

## Improving operations

Among operational improvements planned over the next 12 months, customer centricity and retention take a back seat (29 percent) to underwriting, pricing, and distribution channels (43 percent) and cost reduction (33 percent).

Q: Over the course of the upcoming 12 months what areas of operational improvements will be your focus?

| | 2014 | 2013 |
|---|---|---|
| Underwriting, pricing, distribution channels | 43% | 40% |
| Cost reduction—processes and organization | 33% | 35% |
| Customer centricity and retention | 29% | 26% |
| Regulatory, compliance, and consumer protection | 19% | 21% |
| Human capital realignment/talent management | 18% | 7% |
| Back office operations (LEAN, process improvement, shared services)* | 17% | N/A |
| Risk management, ERM, ALM | 13% | 11% |
| Investments (front, middle, back office) | 11% | 2% |
| Claims settlement and leakage | 11% | 6% |
| Technology—middleware | 11% | 8% |
| Technology—front-end administration system replacement or upgrade | 7% | 15% |
| Finance, accounting, and tax | 3% | 7% |

*(Multiple responses allowed)*

**not asked in 2013*

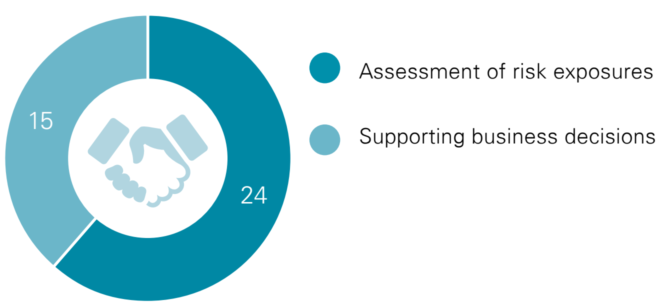
## Focusing on risk management

Likewise, among ERM programs, risk analytics takes a back seat (25 percent) to responding to regulatory requirements (41 percent) and improving alignment of risk levels to business objectives (33 percent).

Q. Which of the following areas do you believe will be a primary focus of your enterprise risk management program over the next 12 months?

**2014**


**2013**




*(Multiple responses allowed.)* **not asked in 2013*

**KPMG analysis:** Respondents' attitudes about operational improvements and ERM—prioritizing business-as-usual initiatives for organic growth, regulatory compliance, underwriting, and cost reduction—capture the disparity between where the industry is now and where it ultimately needs to go. That is because legacy systems, along with "legacy thinking,"[13] represent that largest roadblock to next-generation business models.

According to survey respondents, (charts not shown) legacy system viability is the biggest tech issue facing organizations today (37 percent); extensive IT implementation to modernize existing platforms remains the top long-term challenge organizations face with legacy systems (48 percent); and maintenance consumes the largest percentage of the tech budget (41 percent).

A report by Gartner states that, "Many insurers, acclimated to a business environment that remained fairly static for decades, have not developed the capacity to manage innovation that a fast-moving environment demands. Insurers are missing opportunities that competitors from outside the industry are beginning to seize. . . . CIOs must better balance both legacy modernization and digitalization requirements to help their organization defend and improve their competitive position. The problem for mature players is how to start over, while competing with new players that do not have to deal with the burden of legacy systems."[14]

[13] http://www.insurancetech.com/management-strategies/unraveling-legacy-thinking-5-new-ways-to/240160413

[14] https://www.gartner.com/doc/2643327?ref=clientFriendlyURL

## OUR MONEY IS ON THE REVOLUTIONARIES

The evolutionary theme that emerges from our survey results—change is coming, but not right away—raises the question of how change can occur in this, or any, mature industry and how long it will take.

The challenges of seeking new markets and responding to regulatory demands will always be front and center for leadership—and may remain their highest priorities. Likewise, transformational initiatives may remain as secondary priorities and still succeed, over time, in bringing about the fundamental change the industry requires.

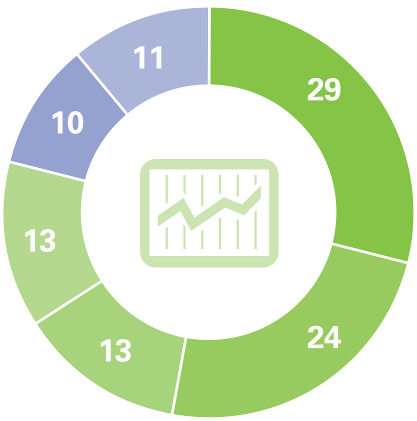
On the other hand, one could argue that until next-generation issues "rise to the top"—as drivers of growth, M&A, investment, talent, and operations—the necessary change will not occur. In fact, that is what we believe. The implications? Instead of an industry adapting to change, it will simply be replaced by new players.

Customers need insurance more than ever, and customers are the ones making the important decisions about the industry. The sooner companies realize that, the better off they will be. In the meantime, our money is on the revolutionaries.

## Survey methodology

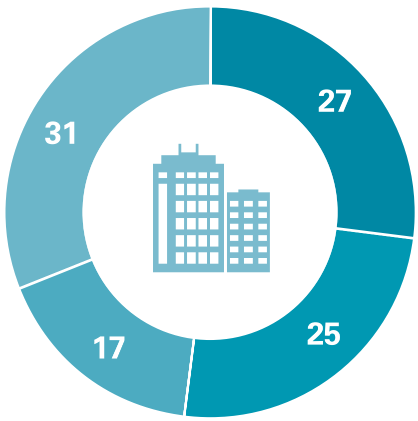
KPMG's 2014 Insurance Business Outlook Survey reflects the viewpoints of 95 senior executives in the United States from across the industry, including P&C (39 percent), reinsurance (24 percent), and life (23 percent). The Web survey was conducted in the second quarter of 2014.

Fifty-two percent of respondents were C-Class in 2014, versus 39 percent in 2013 and 22 percent in 2012. Almost one-third of executives represented companies with revenues of more than $10 billion.



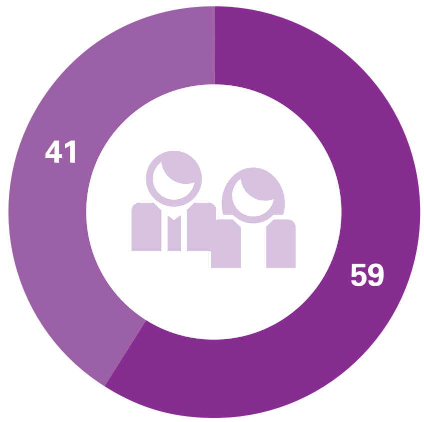

**Revenue**
2014

- More than $10 billion (29%)
- $250 million to $499.9 million (24%)
- $100 million to $249.9 million (13%)
- $1 billion to $4.9 billion (13%)
- $500 million to $999.9 million (10%)
- $5 billion to $10 billion (11%)




**Title**
2014

- CEO, president, owner (27%)
- C-Class (CFO, COO, CTO, etc.) (25%)
- Executive vice president/ managing director level (17%)
- Senior vice president, vice president, or director level (31%)




**Company type**
2014

- Publicly held
- Privately held

## About KPMG

The largest provider of professional services to financial services companies globally, KPMG's Financial Services practice has long been recognized for its presence in and its commitment to the industry. Our dedicated insurance professionals in the United States and globally, are an integral part of the Financial Services team, and this is what differentiates us in the marketplace.

KPMG's national Insurance practice includes more than 1,400 professionals located in 87 offices throughout the United States. Our national practice is complemented by a global network of more than 7,000 Insurance professionals—a network that is vital when our clients require cross-border support. Key marketplaces extend across the globe, with Insurance professionals located in 152 countries on six continents.

KPMG's professionals understand the critical issues that will drive future growth, including:

- Strategy
- Operational improvement
- People and change
- Financial management
- Technology enablement
- Risk consulting and capital management
- M&A and corporate finance
- Actuarial services
- Tax services
- Regulatory compliance
- Transaction and restructuring
- Assurance

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