Keeping Up With the Pace of Change

Demands by Customers Are Driving the Life and Annuity Agenda

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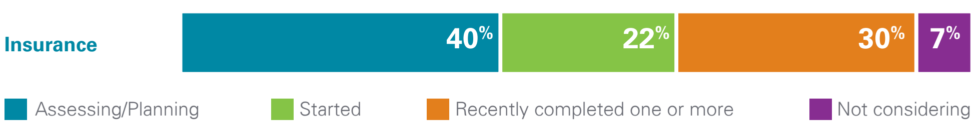
With powerful technology and customer forces continuing to rapidly reshape the life and annuity business landscape, compelling questions are being considered with more urgency in life insurer boardrooms and management suites. Customers want to know whether the industry can keep up with their demands for interaction innovation they now experience with other industries. Investors want to know if the industry is losing ground to digital innovators and whether the industry is forming stronger bonds with customers.

The answers to those questions are not very clear at the moment. Our interaction in the industry and our research indicates that some insurers are working hard to address transformation issues, although we also note that the size of the business does not necessarily correlate with whether the responses are strategic or simply one-off reactions.

Where is your organization on the transformation continuum?

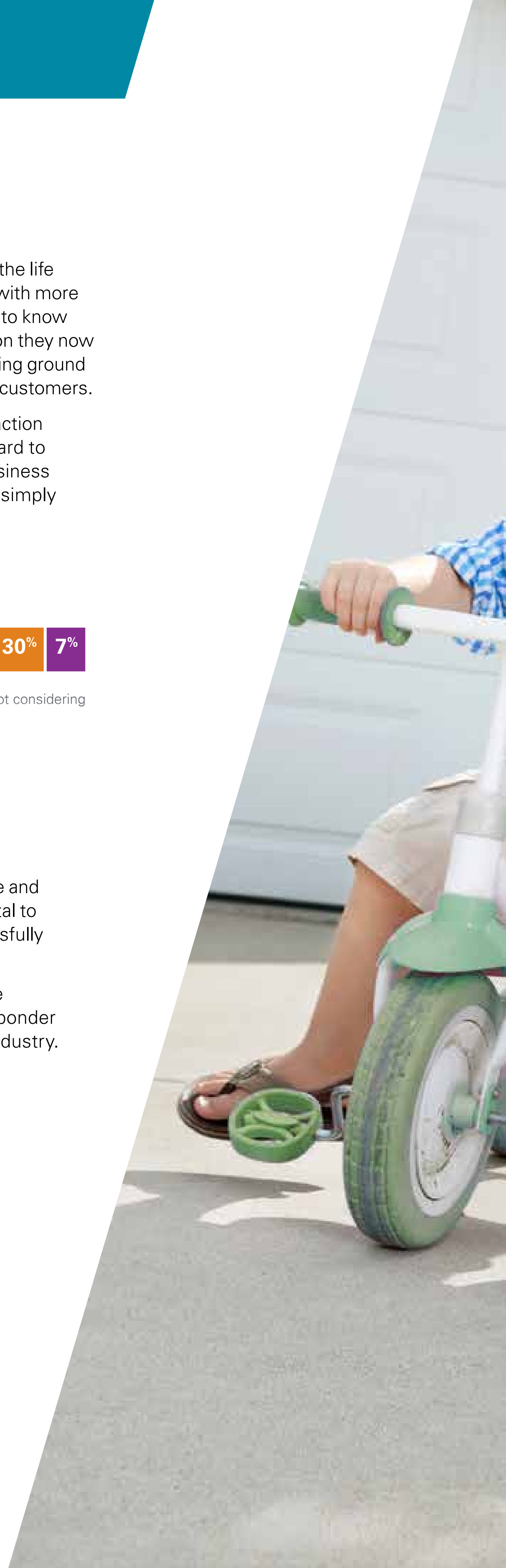


Does not add up to 100% due to rounding.

"From Burden to Competitive Advantage," KPMG LLP, 2014

In our view, the time has come for traditional insurers to act with more resolve and with more speed in addressing the pace of change. Further, we believe it is vital to link innovation with their long-term business strategy if they expect to successfully interact in a fundamentally changed marketplace.

By doing so, the forces that are accelerating industry transformation can be harnessed as engines of growth. Organizations that continue to study and ponder what is going on around them risk irrelevance in this swiftly transforming industry.



As we examine 2015's triggers and forces we initially were struck by the similarities we witnessed early in 2014: Many organizations recognize the need to accelerate the pace of transformation but the recognition did not match the actions to address the issue that is essential for growth—even survival.

We do not suggest that progress is nonexistent. In fact, changes are happening, but we too often see those changes being instituted in a piecemeal fashion, and that there are not enough examples of coordinated, broad, strategic transformation of business and operating models that reflect the realities confronting this tradition-bound industry.

Moreover, we believe there are many more opportunities to strategically reach out to customers—particularly in underserved market segments.

The time is ripe to:

- Open engaging, digital-based distribution pathways
- Address inefficient underwriting processes with powerful, digitized analytical tools
- Recruit new blood into the agents/brokers workforce that is facing a wave of retirement in just a few years
- Attack rigid, duplicative, and aged technology platforms through coordinated upgrade campaigns
- Attract tech-savvy talent to upgrade internal information technology systems and build better customer-facing pathways for communication and distribution
- Leverage powerful insights that spring from fountains of structured and unstructured data.

It is vital, though, to view these challenges and opportunities against some harsh economic, demographic, and social realities: Although we believe the industry can build on the momentum of the past two years, there also is a risk that any momentum could be quickly blunted. We expect to see only slight gains in the U.S. gross domestic product (GDP) in 2015, and another year of low interest rates. And, while we expect the unemployment rate to continue to dip, we see no reversal of ongoing wage weakness (a measure of buying power) for virtually all but the wealthy population in the United States. The vast middle-income segment of the population may very well be counted on to provide the fuel for growth because so many need more life insurance protection and investment education that life and annuity businesses can provide.

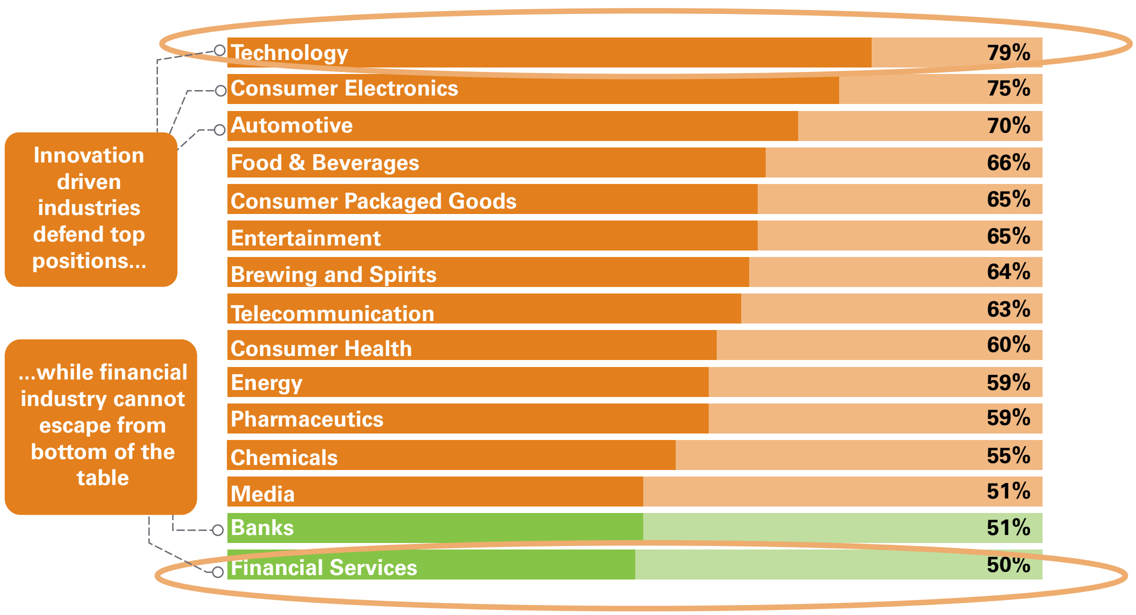
“In the life and annuity business, connecting with customers in a variety of creative and fast ways is essential. It's no longer a case of something life insurers hope they can do; it's a matter of having to do it now. There must be a total commitment to create effective digital and mobile strategies – tied to an over transformation effort.'”

Laura Hay,
National Sector Leader Insurance, KPMG

KPMG VIEW

Here are a few other realities to consider in your next management and strategy session:

- With customers now completely driving your agenda, your strategies and business model must recognize the reality that customers demand that you provide them with the level of service they have come to expect from other industries —particularly the retail industry.
- Many young individuals, in what on the surface would seem to be a rich environment of potential buyers, are carrying whopping student-loan debt, are still looking for work in their chosen field, and are stuck at entry levels.
- The ongoing issue of an aging agent population whose demographic profile remains at odds with the changing profile of America: Here is just one aspect to consider—Hispanics in the United States now account for close to 20 percent of the country's population, and their numbers are expected to explode in the years ahead. Do you have a plan to serve that emerging population,[1] which has expressed mistrust in many of today's insurance-agent pool?[2]
- Single-parent households, according to the U.S. Census Bureau, have doubled since 1970. Many of these households are in desperate need of individual life insurance policies and savings advice. Can you connect?
- About 80 percent of the 12 million single-parent families are headed by women. (U.S. Census Bureau)
- In an annual survey by Edelman Trust Barometer of the most trusted industries in the U.S., financial services is last – and has been for about a decade. What are you doing about that?



Source, Edelman Trust Barometer, 2014

- What about the relatively unmet need to serve the vast middle-income, Millennials (Gen Y), and Generation X segments, each of which repeatedly say they want uncomplicated advice about the need for—and affordability of—life insurance? They also are seeking strategies to boost saving for retirement. Survey after survey over the past decade finds that those who don't buy life insurance, who don't invest in certain retirement and savings products offered by this industry say they are fundamentally confused about how products are described by the people who sell them.

We hope our point is clear: Get moving on these and other critical issues. Everything around you already is changing rapidly. Because your customers insist on new ways to interact with you, we believe that, for many of you, your business processes and operations need immediate attention from cost and effectiveness perspectives. Simultaneously, there is an urgent need to adopt the technologies that can help you transform to meet the so-called disruptors who already are using them in the marketplace.

These are the organizations that have built better distribution channels, they can segment markets to produce extremely granular results, they have funding, and they are on the prowl.

Hence, our message to pick up the pace. Every organization that is chasing a piece of your business already is in the race.

[1] U.S. Census Bureau/LIMRA, 2014

[2] "The Hispanic Market: A Huge (and Growing) Opportunity," Life Health Pro.com, February, 3, 2013

The life and annuity businesses are littered with compelling data points, offering opportunities and serious challenges:

- The life market continues to be woefully under penetrated in the United States, providing substantial opportunity to insurers who can go on the offensive in a systematic and strategic fashion. A recent industry survey found that half of people in the survey did not own an individual life insurance policy. [3] A sizeable chunk of the group said they were covered by a group plan, but by not having individual policies, they are left with a gaping risk, which presents a real opportunity for proactive insurers with well-designed plans to connect and build trust.
- A major U.S. life insurance company reported in 2014 that the people it surveyed said they needed about $540,000 worth of insurance, but that group admitted having only had $220,000 in insurance last year.[4]
- About one-third of working Americans have less than $1,000 saved in individual retirement or savings accounts; 60 percent have less than $25,000.[5]
- When a national survey asked the price of the annual premiums for a $250,000 level-term life policy for a healthy 30-year-old non-smoker, the median answer from individuals under the age of 25 was $1,000 a year. The actual cost? About $125 a year. Nearly 20 percent of the group thought the cost was $3,000.[6]
- When asked to name any single insurance company that sells life products or retirement products, only 3 in 10 could name one company—and 4 in 10 in that group actually had an individual life policy. What do those numbers say about making an impression on the consumer market?[7]
- Annuity products generally remain a tough sell. Consumers and financial planners alike often consider annuities complex or confusing instruments, riddled with gobbledygook words and phrases that turn off potential buyers and breed distrust about the sellers. But, as we will see later, the growth rate of some varieties of annuities is encouraging.
- Actual engagement with customers still too often is woefully infrequent (sometimes as infrequently as twice a year), making trust building and cross-sales very difficult.
- In a ranking of 15 industries in the United States based on trustworthiness, the financial-services industry was rated number 15, where it has been for about five or more years. (Unsurprisingly, technology companies remain in first place.)[8]
- Social media channels among a wide swath of consumers (regardless of age, income, and household-wealth levels) are becoming one of the most trusted sources of information about insurance products and services. But the source of the information is not coming from the industry—it is coming from actual social media users in their informal "tech conversations." In fact, multiple sources rate insurers' social media sites as boring— or maybe worse—confusing.

– **About one third of working Americans have saved less than $1,000 for retirement;**

– **60 percent have saved less than $25,000 for retirement**

[3] "Life Insurance Gap Represents Sales Opportunity," BenefitsPro.com. September, 2, 2014

[4] "Do You Have Enough Life Insurance?" Money/US News and World Report, July 16, 2014

[5] "Retirement: A Third Have Less Than a $1,000 Put Away," USA Today, April 1, 2014

[6] "Consumers Overestimate Cost of Life Insurance," LifeHealthPro.com, April 7, 2014

[7] "Whatchamacallit: Insurance Brand Awareness and Consumer Mindshare," LIMRA, 2014

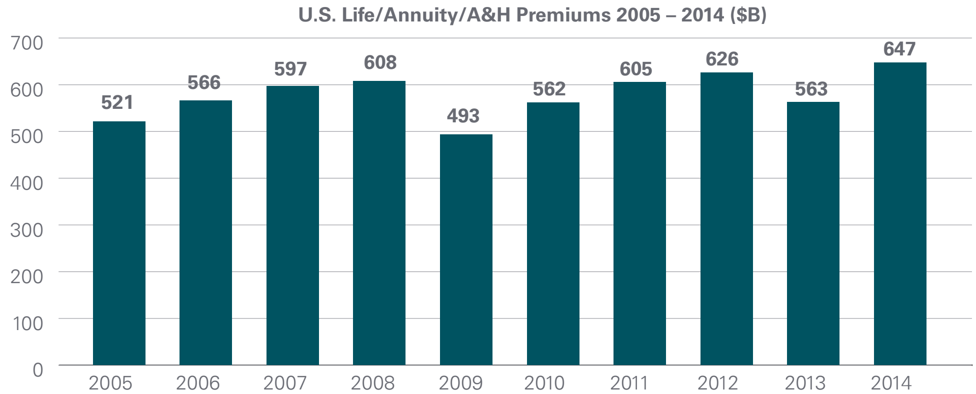
[8] Edelman Trust Barometer, 2014

KPMG View

So, what is the answer? First, it isn't simple. Second, the road to fixing many of these issues is a long one. Third, stop pondering; start doing.

- Think of how powerful an education series would be, using interactive mobile technologies that are linked to advisers and agents. And think of the cross-selling opportunities.
- Given that the number of single-parent households in the United States is rapidly increasing, there is a pressing need for low-cost insurance as well as targeted messaging. This is an audience that needs advice and education about financial needs.
- If the median response to the survey question about the price of a $250,000 level-term life policy was off by a factor of 10 times, it would seem that life insurers will need an aggressive campaign focusing on affordability —and protection.
- Make a strategic decision to tie name recognition to your products, services, and people. Do not dismiss out-of-hand any possible way to raise your profile and increase your education effort—everything from creating new ads to gamification—which uses very popular games on mobile devices that link fun and education to your product and education efforts. Some insurers already are employing gamification programs, just as auto companies, banks, and other industries have done recently with tangible results.
- Learn from retailers and other industries that have leveraged social media and digital sales to create meaningful and frequent touch points with customers.
- To win the hearts and minds of more customers, insurers must make increasing the trust level with customers one of their key agenda items in 2015.

When it comes to premium growth in 2015, published reports use phrases such as "more of the same" and "another flat year."[9] We would be hard-pressed to disagree. A possible bright spot? Indexed universal policies, with somewhat more predictable returns, are expected to improve. However, we also expect that state regulators' scrutiny of how their possible returns are presented in sales and marketing literature to investors will increase this year.

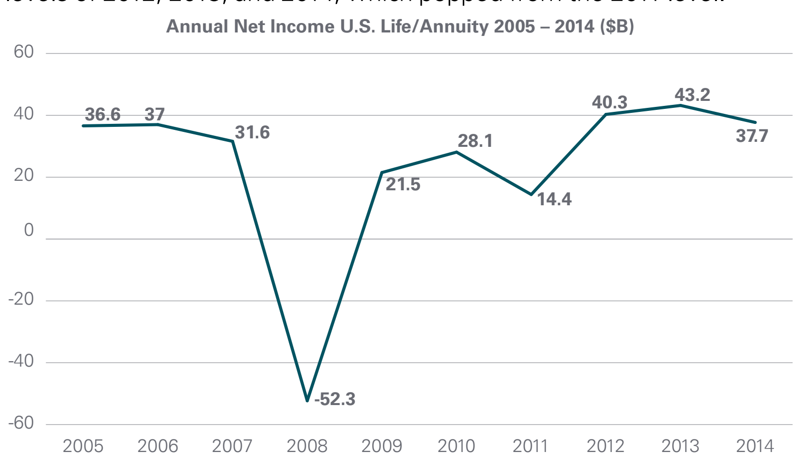


Source: SNL Financials, March, 2015

The decline witnessed recently in the once-popular lifetime guarantee universal life policies is not expected to reverse anytime soon because of concerns about making guarantees in the ongoing low-interest-rate environment. Not only were fewer lifetime guarantee policies sold in 2014, but the average face amount also dropped in 2014 by 25 percent to an average of about $300,000 per policy.[10]

> *Since 2004, the number of individual life policies purchased per year has decreased 21 percent, and their face value has decreased about 10 percent.*
>
> **2014 Life Insurance Fact Book – American Council of Life Insurers**

While the lower-yield environment remains a significant issue in the life and annuity sector, we expect net income to remain under pressure, although signs seem to indicate that profitability will be comparable to the levels of 2012, 2013, and 2014, which popped from the 2011 level.



Source: SNL Financials, March, 2015

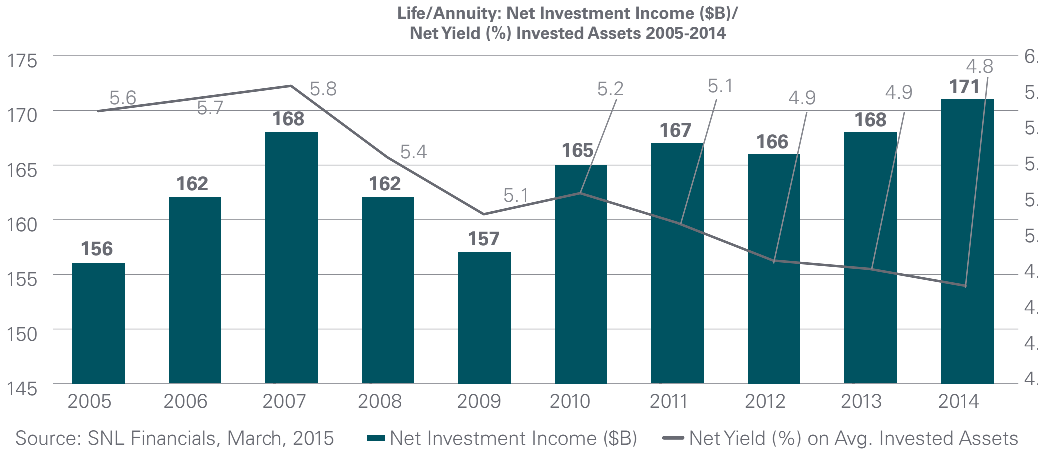
[9] "LIMRA Report: Expect Flat Life Sales in 2015," LifeHealthPro.com, December 11, 2014

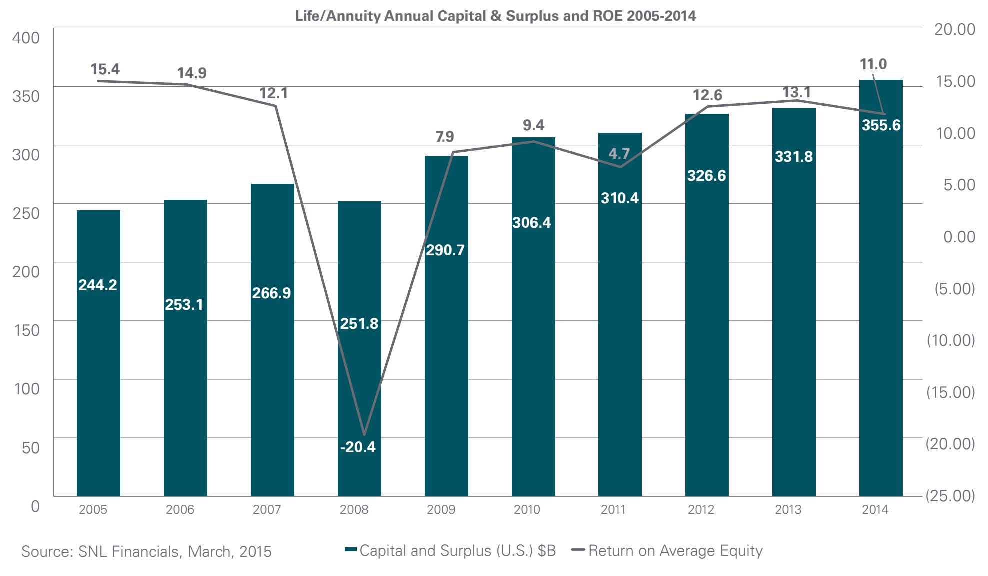
[10] Ibid

And, while a slow, steady rise in interest rates would be welcomed, a sharp jump could cause a number of financial complications, although we see little threat of such a rate jump on the immediate horizon. However, if we've learned anything from the past two decades in the global financial markets, it is that quick changes come with little warning and many institutions have been unprepared.

A gain in net income and other drivers pushed life's surplus to a record level in 2014, which may put pressure on pricing this year. On the flip side, surplus levels this high could allow for investment in mergers and acquisition (M&A) activity, and perhaps even the creation of life insurance company venture capital (VC) units. Those VC organizations could build strategic alliances with some of the technology firms that are pushing ahead in the development of new products and operational activities.

Return on equity (ROE) in the life sector has improved for the past three years, and there is no indication of a dip to come for life's ROE in 2015.





The job of melding strategy, digitization, and transformation begins with an uncluttered vision of how to identify and deliver on customers' demands.

There is no question the industry needs to rely heavily on the newest analytical tools (and the talent to deploy them) to identify the market segments that are underserved and better serve existing segments. Insurers must quickly act on the intelligence and make the "no-turning-back" decision to radically transform the way they now do business.

In suggesting that this industry pick up the pace of change, we recognize that it is easier said than done. The reasons for the slower-than-required pace of transformation are as varied as they confounding. Regulatory demands are broad, sometimes at odds with each other – particularly for insurers that have a multi-national footprint and must deal with a number of cross-border regulators. But, it also needs to be said that some of the barriers to change are self-created and not being aggressively deconstructed.

Top three triggers for transformation (across all industries)

Transformation is triggered by many diverse causes, with none being considered a primary trigger by more than a third of overall respondents.

33% **Customer demand**
(changes in customer focus, buying patterns/preference)

30% **Coping with change in technology**

29% **Domestic competitors**

Source: "Business Transformation and the Corporate Agenda," KPMG LLP, 2014

The hurdles come in many forms:

- An industry known more for an aversion to quick change
- A culture that (more often than not) creates internal turf wars
- A compensation-incentive structure that build silos that work against today's necessity for overall internal collaboration to help accelerate the acceptance of change.

One of the most telling examples of a disconnection in the path forward was found during our research, surveys, and discussions with industry leaders in 2014: Relatively few insurers actually are leveraging digital and mobile technologies as a means to spark the transformation and aligning those efforts with their stated business strategies.

Though many traditionalists in this business may not want to hear it, we believe the insurance business (like many other businesses today) has to view itself as a technology business that is used as a delivery system for insurance products and services. That statement is not meant to suggest insurance specialists have no role in this technology business. Conversely, it means that those specialists must first rapidly educate themselves in the technology, and then create and deliver the message across market segments about the value of life policies, annuities, and investment advice.

In ***Transforming Insurance***, a recently published report by KPMG International, one statistic jumped out jumped out in a global poll of insurance executives: Only a third of the respondents said their digital initiatives are fully aligned with their company's overall strategic objectives.[11]

> "Having the ability to quickly, accurately, and strategically leverage the enormous amount of data in our industry will provide an insurer with a powerful competitive advantage."
>
> *Gordon Lunsford, KPMG*
> *KPMG National Management Consulting Leader, Insurance*

With those findings as a foundation, this report examines a number of associated ideas and possible opportunities to exploit the power of transformation, and rev up the engine of growth through agile, coordinated deployment of new ways of working and thinking. Agile organizations anticipate critical industry changes and respond based on a strategic vision that recognizes their next-generation customer profile. That idea is succinctly captured later in this report by one of KPMG's advisory leaders who suggests that successful transformation in part hinges on customer connectivity, which requires asking: "What is my customer going to look like in the next five years?"

Progress must be propelled by the understanding, trust, and leverage of the explosion of technologies that at the moment appear to be deployed in this industry in a fragmented, one-off manner.

KPMG VIEW

- Marry customer-centricity efforts with a strategically coordinated, agile, digital transformation program to create exceptional customer experiences.
- Pick up the pace of digitization—particularly as it relates to exploiting the power of predictive modeling and data analytics to drive smarter business decisions throughout the organization and create new products and services demanded in under served market segments.
- Maintain vigilance surrounding ongoing uncertainty in the state, federal, and global regulatory environments, and develop contingency plans to meet new demands that may be in the offing relating to "modernization."
- Increase focus on cybersecurity.
- Be open to partnering with technology firms that have created new solutions that can be applied to the insurance industry. These avenues may prove instrumental as a means to plug gaps in knowledge, technology, and skills—and embolden strategies to create new products, while instituting innovation in organizational and operational processes.
- Step up efforts to attract data-science talent as part of an overall focus on enhancing data and analytics and predictive modeling for better decision making.
- Focus on distribution improvements as a means to meet threats created by new, nontraditional entrants.

After decades of securing business by leveraging scale and institutional underwriting expertise, life and annuity businesses are coming to grips with the knowledge that such a model is quickly losing relevance. The model is rooted in what may be an outdated customer profile, and it has the potential to create internal organizational silos that stifle teamwork and drive up costs.

Forward-thinking corporate leaders are recognizing that customer segmentation and focused outreach—tied to an overall growth strategy that incorporates a heavy reliance on powerful technological advances—inevitably will play a large role in determining future success.

A KPMG survey,[12] conducted in 2014, reported that a clear majority (52 percent) of industry executives said customer preferences, buying patterns, and needs would mostly drive sector transformation. Coping with changes in industry-relevant technology was second (45 percent).

Industry participants must now distinguish themselves from key competitors by having to impress customers to retain current business and gain a foothold in new target markets. Price always matters to customers, but our view is that it is risky to underestimate the degree to which customers are looking for the right value proposition.

A customer-centric business digs out actionable, value-based, and segment-led insights from data. It uses technology-driven knowledge to build multichannel delivery methods. Its core mission is to relentlessly seek customer inputs to drive innovation through a flexible technology infrastructure (replacing disparate legacy systems), in addition to actionable information in order to be viewed by its customers as a valued, trusted, agile, and responsive partner.

We are seeing movement in that direction, and are encouraged that evidence is mounting that momentum can be gained in 2015. Through multichannel experiences, customers expect that they can interact via a mobile app or more functional website that offers video chat or instant messaging, and reduces the hassle of booking face-to-face meetings. Cross-functional collaboration at most insurers, given the mix of business and varying functions, integrates matters more quickly, without destabilizing operations.

Carriers have to decide what is best about their marketing and how they can refine it to target the most viable growth segments. More nimble insurers have been smart about using newer analytics to mine behavioral and demographic date and improve modeling. Many have studied the successes of other industries that instituted agile tech solutions.

Hitting the Middle (and Other Growing) Markets

Granted, the much-sought-after "high-net-worth" household category attracts a lot of attention among financial services businesses. The people in that desirable sector have money to invest, the assets to protect, and they have demonstrated a willingness to spend when they perceive value. So, it is no wonder that this group represents an enormous sweet spot for people who sell insurance, annuities, and investment advice. However, despite the amount of money the group controls, it is essentially a limited category being chased by quite a lot of businesses.

Increasingly, we see real opportunity for the industry in the less affluent, but much larger middle market, which is a broad, multi-faceted market. Selling into it, however, requires significant planning and execution. The huge and multi-faceted middle-income portion of the U.S population that has not been given the attention that the high-net-worth segment has received. But nevertheless could serve as a springboard for industry growth. (The middle-income segment is defined as those who fall into the 25–64 age group and with annual household incomes of $35,000 to $99,999.)

> "What's becoming clear at traditional insurers is the recognition that for growth to take root there has to be a real understanding of a few key elements: What is my customer going to look like in the next few years? What customer segments am I missing, and how can I use data analytics to understand and exploit opportunities in those segments? How can my business stand out among newer entrants with newer platforms? What do customers want from me that they aren't getting now? And, how can customers be served very quickly? It's all about using technology and bold, new thinking in order to connect a customer-centric view with the means to deliver relevant products and services.'"
>
> – *Matthew McCorry, KPMG National Advisory Industry Leader, Insurance*

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[12] "2014 Insurance Industry Outlook Survey," KPMG LLP

The job begins by gaining an understanding of the market's many segments that account for this U.S. demographic quilt. Therefore, an important first step would be to focus on the life industry's agent population and get an understanding for why the middle market has not been exploited to the degree that it might. A key initial step will be to address recruitment of new agents and confront the agent population's relative lack of diversity when compared to the changing face of America.

The average age of a life agent or broker, according to LIMRA, is 56 years old, and the percentage of Hispanic, Asian, and African-American agents is lower than the overall population.[13]

Addressing that challenge, and making inroads, could help boost the penetration rate of life insurance in the overall U.S. marketplace, which is at about a 50-year low.

Aside from the agent/workforce issues, there must be a recognition of the growing "two-tier" U.S. economy. These two tiers are distinct: Well-off households continue to increase their wealth while middle- and lower-income households are losing ground in wages, and having to work longer hours or two jobs to provide for themselves and their families. That two-tier reality already has reshaped how businesses across industry lines are operating. Data from the Federal Reserve show incomes for the past decade or longer have been either flat or falling for all but the top 10 percent of U.S. income earners since 2010.[14]

Even so, a very large segment of that "other" 90 percent is in great need of advice for retirement planning, they need life insurance policy, and (perhaps most of all) they need education about both the affordability of products and services and how they can improve their lives in future years.

The underserved markets are as varied as they are potentially valuable:

- There is the rapidly growing and steadily more-prosperous Hispanic, Asian, and African-American populations in the United States. The industry's challenge is being able to reach segments such as these that have low representation among agents and brokers.
- The large Millennial segment is coming into financial maturity, and already saving for retirement. But their trust in insurance agents remains low.
- There is a large number of single-parent households (about 33 percent of all households in the United States.[15]) that need assistance in understanding life and investment products. For example, in four in ten U.S. households with children under age 18, the mother is either the sole or primary source of the family's income.[16] How does your agent force reflect that demographic? Women use social media more than men and they—more than men—believe life insurance and saving for retirement is very important.[17] What are you doing to meet that reality?
- The portion of Baby Boomers who need more assistance in learning how to save more for retirement, or need more education about annuities as they begin to move out of equities. Among the 64 million U.S. Baby Boomers, 10,000 of whom will turn age 65 every day for the next 20-plus years, about a third have less than $50,000 in retirement savings, while 40 percent of those in "Generation Y" (ages 18 to 33) already have put aside that amount.[18] Some of those Boomers may incorrectly believe they have few options left to them, but with the right advice from insurance/adviser professionals, they may be able to cut spending and increase savings.
- Boomers will also need to revisit long-term-care products, which for many years have had a reputation for being complicated and expensive. Advances on those issues have been made, but the education of their value is still a major challenge for the industry.
- The Gen Y savers already well on the road to building a nest egg may not understand the need for life policies at this stage in their lives, and they also may need long-term advice if the asset allocation in their savings programs are too aggressive or too conservative.

At LIMRA's 2014 annual convention, the organization's president and chief executive officer Robert A. Kerzner stressed that if the life industry's goal is to boost sales, it must first understand how fundamentally the U.S. demographic profile is changing and then use that information to assess whether insurers' business and operating models are fitting the changing demographic landscape.[19]

Kerzner's message was blunt: The diversity of the United States in not necessarily reflected among the people trying to sell insurance products and investment products and advice.

[13] "Occupations with Worse Aging Problems Than Insurance Agents," Life Health Pro.com, November, 11, 2014; "Hispanics in Insurance: A Study in Diversity," Life Health Pro.com, April 1, 2012

[14] "How a Two-Tier Economy is Reshaping the U.S. Marketplace," The Wall Street Journal," January 28, 2015

[15] "U.S. Census Bureau

[16] "Pew Research Center/LIMRA

[17] LIMRA

[18] "Troubling Survey Shows Baby Boomers Don't Have Enough Savings to Retire," Financial Advisor Insights/businessinsider.com, August 25, 2014

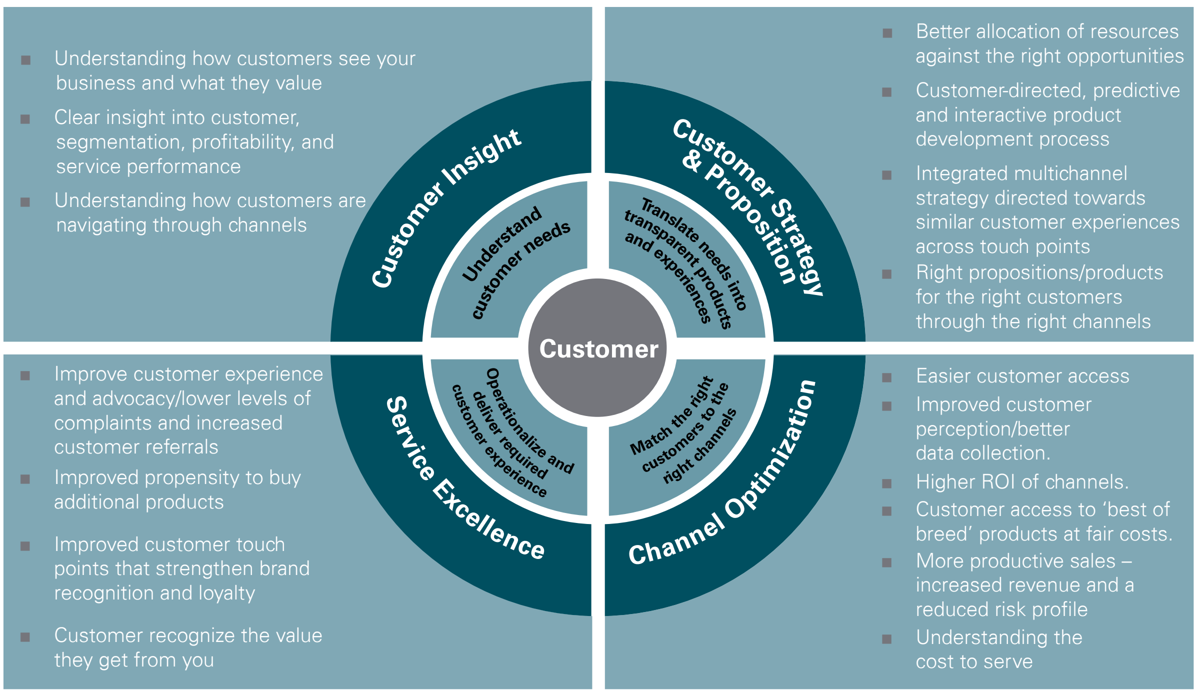
[19] "Connecting to Today's Consumers Requires Innovation and New Approaches," Robert A. Kerzner/LIMRA, (video)

He ticked off a number of compelling statistics: Citing U.S. Census Bureau data, Kerzner said the Hispanic population in the U.S. is now about 57 million people, but by 2060 it will be more than 125 million. What are now called "minorities' in the U.S. (right now about 37 percent of the population) will be the majority (57 percent) in that time period, and the country's Asian population will double in that time period in 2060.

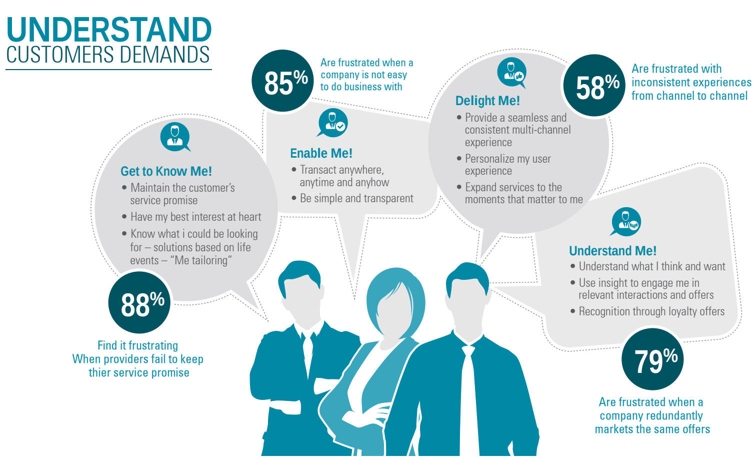
Kerzner asked his audience what they are doing now to "listen" to the needs of those constituencies, and what they are doing at their businesses to meet the needs that now are not being met. In 2013, LIMRA produced a study that discovered 87 percent of U.S. Hispanics they surveyed said they need life insurance to cover burial and final expense. But 64 percent of respondents said they had no life insurance because they believed it was too expensive, even though they did not know the actual cost of a basic term policy.

KPMG VIEW:

Attributes of a Customer-Centric Insurance Organization



Outreach also depends greatly on the degree to which insurers make good on product innovation, after they've gained the necessary customer intelligence. Industry leaders will have to refashion products accordingly and accelerate the rollout of new offerings.



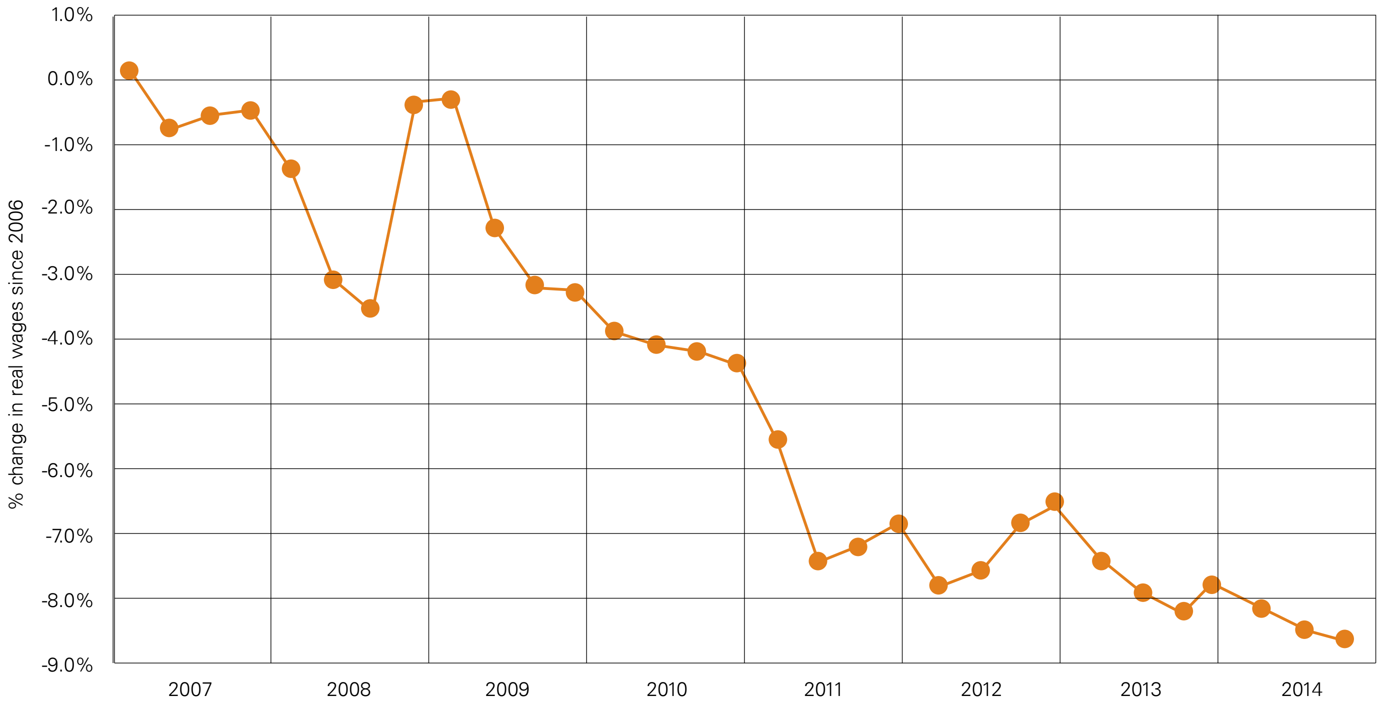
Source: "Finding the Customer through Data & Analytics," KPMG, December 2014

Middle-Market Dilemma
This segment of America hit hard by the recession in terms of lost savings, declining home values, and investment levels, still is dealing with a drop in "real wages."

Research firm Pay Scale Inc., which was released in January 2015, indicates that, since 2006, wages have risen 7.4 percent overall in the United States. However, when inflation is factored in, U.S. "real wages" – a measure of buying power for full-time private industry workers – have actually fallen 8.7 percent in that period.

That kind of data suggests that life and annuity companies have quite a bit of work to do in creating a compelling message that will convince middle-market consumers that buying insurance, annuities, and investment advice is a smart decision to protect themselves and their families, even when they are strapped financially.

PayScale Real Wage Index: National (U.S.) by quarter
The insurer who can connect with consumers by winning their trust and by understanding their life circumstances has a much better chance of tapping into middle-market buyers.



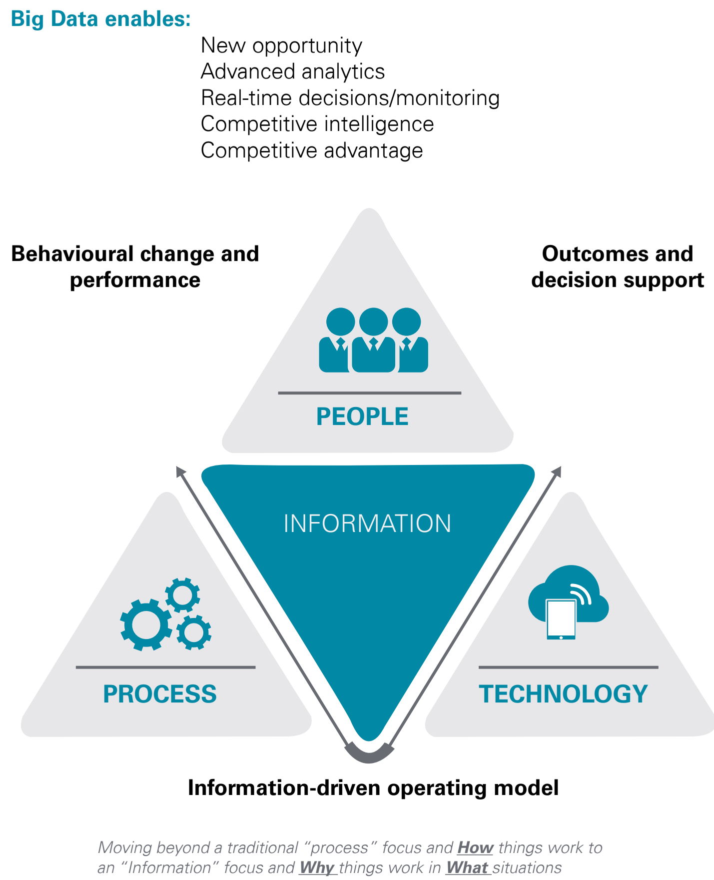
Source: PayScale Inc: Used with permission

Keys to Connectivity
- Client for life is a major focus as cross selling and customer retention: Start to gain momentum.
- Understanding of customer needs and adjusting operational excellence are critical to meeting those needs.
- Developing the right digital interfaces to improve the customer experience in alignment with cost optimization across channels cannot be delayed – Get going!
- Continue your drive for more advanced techniques in product development and pricing.
- Relentlessly focus on enhancing your data analytic capabilities to improve customer loyalty/retention and reach the much-desired and (the eventually lucrative) younger population.
- Strive to improve distribution strategies, while educating career agents on the impact and advantages of the power of technology.

Life insurance companies have access to more data than ever before, which is good news for industry leaders looking to enhance business results through robust data analysis. Yet, transforming data into value at the pace required to stay competitive is no small feat.

The reality is that life insurers are scrambling to gain an accurate, enterprise-wide view of their tsunami of information in an attempt to extract precise (even real-time) knowledge. In fact, the struggle centers on the ability to see the true value of their data so the organizations can personalize customer experiences.

The critical issue, therefore, is not the availability of data, but identifying what data to gather, how to analyze it effectively, and how to apply the results to the business. When polled as part of KPMG's 2014 transformation survey, only 20 percent of insurance executives said their organizations do "extremely well" in implementing business transformation initiatives related to data and information.



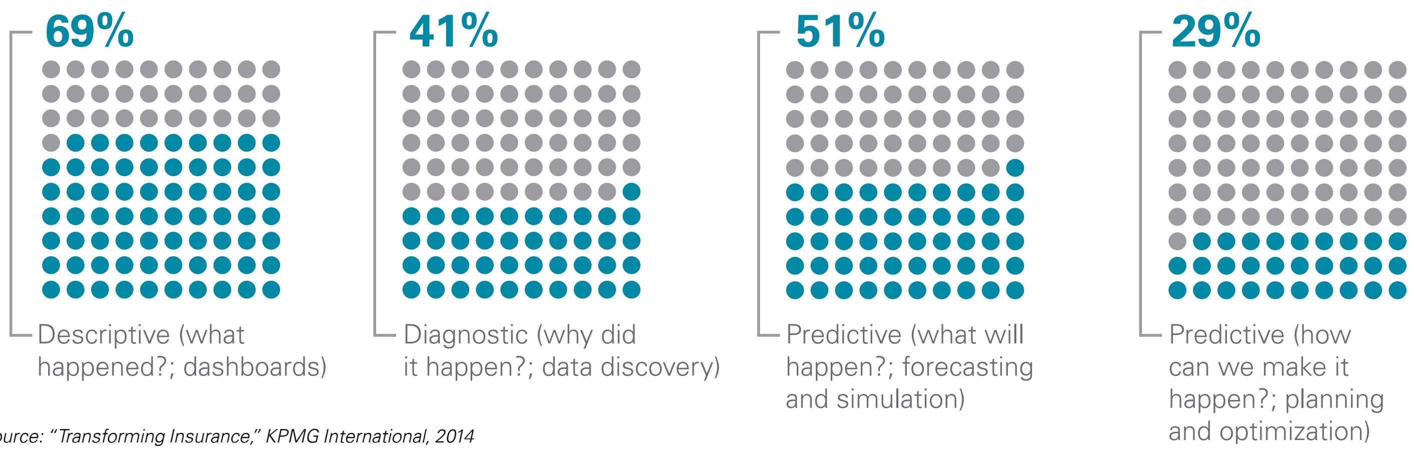
Source: "Data, Data, Everywhere!, KPMG LLP, September 2014

What has become very clear in the past several years in insurance (and in other industries) is that capabilities relating to data and analytics (D&A) and predictive modeling will go a long way in determining the growth rate of industry participants.

Our experience in the field suggests that many insurance organizations are currently only focused on just a fraction of the benefits that superior D&A and predictive modeling can offer. It's not for a lack of effort, however. In KPMG's 2014 report, ***"Going Beyond the Data: Achieving Actionable Insights With Data and Analytics,"*** businesses from a wide swath of industries suggested that their "greatest challenge was in integrating data technology into their existing systems and business models."

Despite understanding the need to double-down on their D&A investments, we have found that the majority of insurers globally are still focused on the past, either focused on applying data analytics to work out what happened or why it happened. Less than a third of executives who participated in a KPMG International survey in 2014 said their company uses predictive data analytics capabilities.

What type of data analytics capabilities do you currently use?



Source: "Transforming Insurance," KPMG International, 2014

Cloud Computing

It's unclear the degree to which major U.S. insurers will switch to cloud computing on an enterprise-wide level. Roughly half the executives that KPMG surveyed last year said they were moderately embracing the cloud, but only 10 percent reported adopting the technology aggressively. Another third of respondents—the majority of which worked at large firms in the life industry—said it was still a discussion in progress.

> **Only 20 percent of insurance executives said their organizations do "extremely well" in implementing business transformation initiatives related to data and information.**
>
> **KPMG Transformation Survey, 2015**

Yet it's clear that an increasingly large number of U.S. companies are headed in the direction of cloud computing, because the inherent value of the technology has been clearly established. The benefits of the cloud—in many ways—make it a viable way for large, complex organizations to become more agile and technologically competitive. In our view, it's imperative that senior management and company boards make a decision in the very near future about the degree to which they want to leverage the cloud. We do recognize, however, that insurers have shied away from the cloud for fear it will make them more vulnerable to data security breaches, a legitimate concern.

Discussion about the cloud this year, in our view, should be predicated on the degree to which current rivals and emerging competitors have adopted the technology, and to what degree it can be used to keep up with them, or put a firm ahead of its competition and position it aggressively to capture future growth in the market. Lastly, the board and management should commit to an implementation time line based on the degree to which (and the value that) the cloud can bring to its key business units and core processes.

In the world of data, we have seen that it's not about "big data." Instead, it's about enabling better analytics to solve real business challenges while focusing on a customer-centric lens.

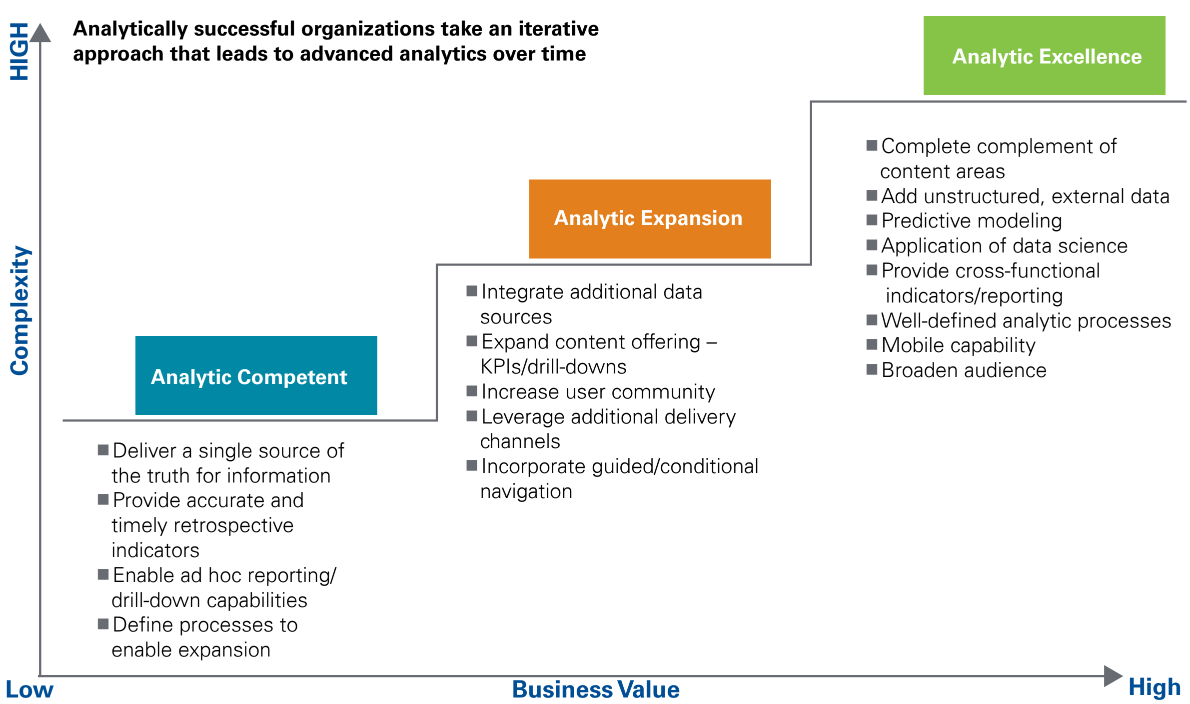
Big Data Perceptions

Perception: Big data is only about massive data volume REALITY: It is variety, velocity, validity and volume	Perception: Big data is for social media sentiment analysis REALITY: It's about viewing data sources broadly	Perception: Big data is a technology issue REALITY: It is a business issue	Perception: The more data you have, the better the insights REALITY: Having the right data is more important than the most data

Analytic Perceptions

Perception: Analytics is about software and tools REALITY: It's about making better decisions by asking better questions	Perception: Analytics is the newest business trend REALITY: It's a permanent change in the business landscape	Perception: Analytics is what data scientists do REALITY: It's about enabling employees across the organization, not a silo of specialists	Perception: Predictive analytics is the answer REALITY: The adoption rates for predictive analytics is still relatively low, leaving room for advancement

Analytics doesn't happen overnight—it's an iterative process. The journey up the maturity curve continues to provide business value. Insurers that have not already begun on this journey must take action now.



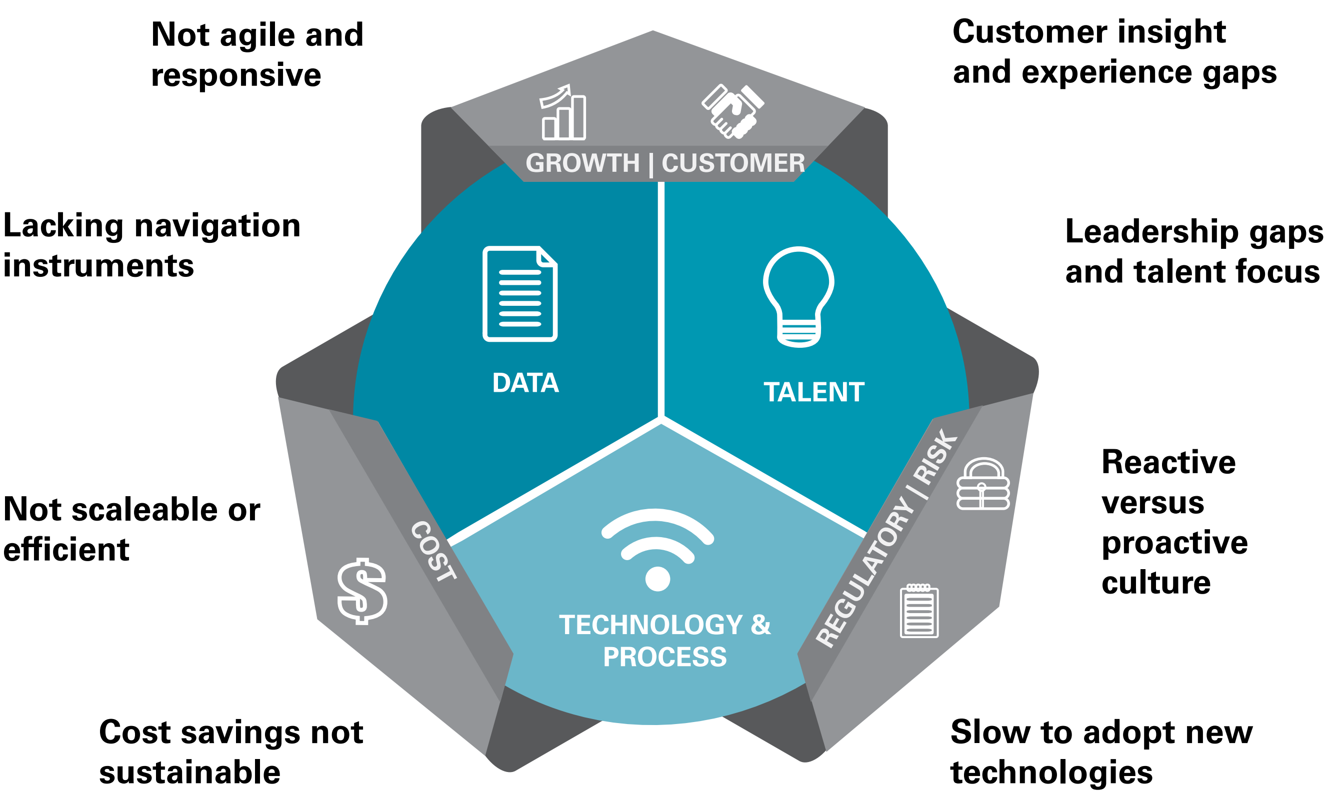
KPMG VIEW

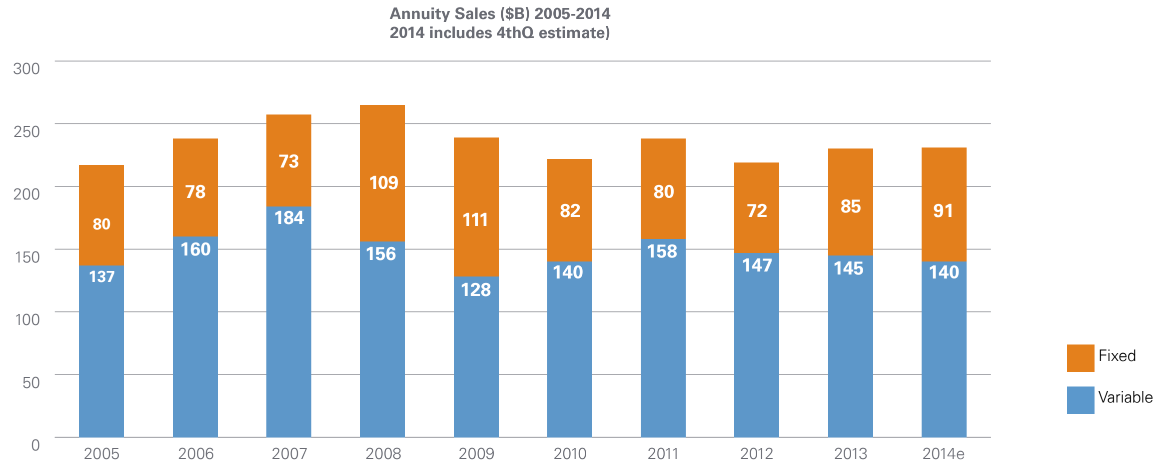
- Integrating the value of new computational and analytical tools and expanding the universe of industry-relevant data sources should be at the top of the list on the change agenda.
- In the past, change management in information technology areas was defined and run by the IT team. It's time to elevate the issue to a higher level of decision makers and, ultimately, into the boardroom.
- There needs to be a cross-functional strategy to secure the buy-in of functional heads, sales leaders and line managers, before modeling specialists design new applications. Otherwise, it's unlikely that teams engaged in these activities will integrate them into longstanding business practices and work habits, whether it be in underwriting, or product pricing.

Key C-Level Questions for Consideration When Evaluating Analytical Capabilities

- Why can't we launch or integrate new products and businesses quicker?
- Who are our most profitable customers and how can we realign our services to attract/retain more of them?
- What does it cost to service a customer, and how do we reduce cost while improving customer experience?
- How can we unleash the latent capacity in our workforce to generate more business?
- How can we exploit data and technology to grow our business and improve our results?
- How do we build a culture that achieves continuous and sustained operational improvement?

Innovation Gaps





Source: LIMRA, used with permission, November 2014

With so many Boomers seeking financial security and predictability in their retirement to address the risk of outliving their assets, annuities would seem to fit that need. Indeed, annuities are valuable instruments to many individuals in the entire market. The market for these products has been marked by turbulence over the past several years, and in some ways has been a tough sell through advisers who report that products' complexity turn off many potential buyers—as well as the advisers themselves.

Our view on annuities is that their value is under appreciated among the buying public because of a general misunderstanding about how they work—a lack of education – and the complexity that accompanies their marketing. We also believe that there are demonstrable opportunities in annuities in 2015 and beyond if insurers and their distributors can unclutter the messages around them, use plain language to describe them, and focus on education efforts.

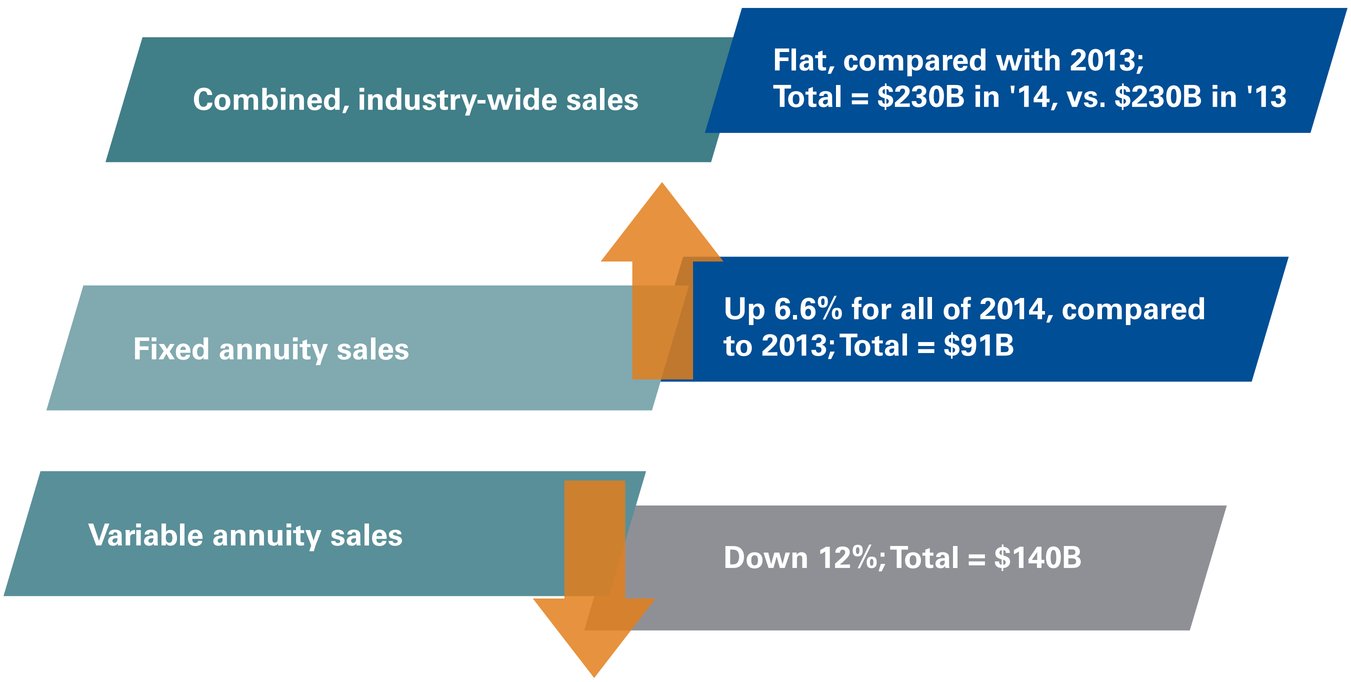
Part of the attraction of annuities can be seen in the number of private equity (PE) firms that jumped in the annuities marketplace in a big way over the past few years. While we expect that pace to slow somewhat, in comparison to 2012, 2013, and 2014, we still believe PE will remain an active player this year and beyond.

In 2014, despite relatively stable economic conditions, fixed annuity sales unexpectedly increased considerably, compared to 2013 and prior years.

While it is unsurprising that products providing guaranteed income for retirees are popular, what is surprising is that the historical drivers typically evident when fixed annuity sales increase were not present in 2014. It will be interesting to follow the path of sales of fixed annuities in 2015.

Fixed annuities sales often increase when interest rates are high, primarily because higher interest rates attract buyers looking to lock in a higher return. And, variable annuities historically have been attractive when the equity markets are booming, which offers the chance to follow the equity market path. But, in 2014, despite low (and falling) interest rates, fixed sales outstripped variable sales.

No doubt, Baby Boomers—seeing equity markets soar in the past five or more years—saw a chance to cash out of the equity markets and buy into a fixed product, despite the anemic interest rate environment. The question for 2015 is whether that trend will continue, through such products as fixed indexed annuities, which can offer at least some upside growth if the markets gain ground.

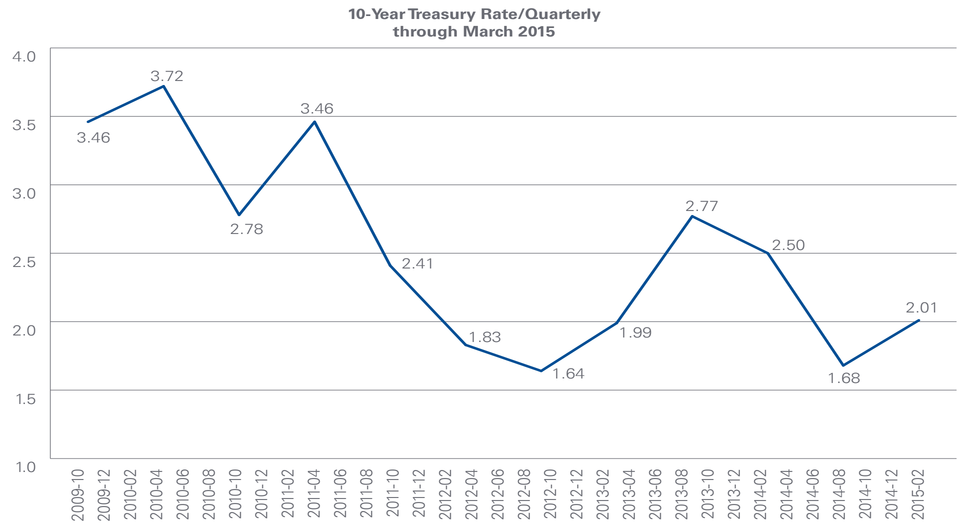


KPMG VIEW

- While it may make sense for some life insurance companies to exit the annuities business, as has been the case for the past several years by selling to PE firms, there is upside potential for insurers that focus education about annuities on two fronts (buyers and sellers), and by demystifying the products.
- Some suggest that education effort should first be focused on agents who entered the business in recent years, and who have demonstrated a willingness to educate themselves about the benefits annuities can offer clients. Long-time agents, who for years have struggled with explaining annuities to their clients, may need more one-on-one training to help move the sales-growth needle for annuities.
- In either scenario, there is a need to make a firm commitment to avoid using terms and phrases that confuse buyers.
- With millions of Baby Boomers retiring the time is right for organizations to confront the challenges that have stymied sales of annuities in the past.

While nothing ever is certain, the interest-rate environment in the United States look likely to remain relatively low through the year. Because of the importance investment returns play in the performance of the overall business, there is a significant premium on managing not only the investment arm of the business but the overall business as well.

It will mean leaders in life insurance must focus on new product development and distribution challenges, superior capabilities in enterprise risk management functions, cost efficiencies across all operations, and on creative – yet prudent—to allocate assets.



While operating within regulatory constraints, we still expect the risk level of U.S. life insurers' investment portfolios to gradually increase in 2015, although (for most) not to the point where credit ratings agencies raise red flags.

We also expect to see increases across the alternatives' board: In private debt, private equity fund of funds, real estate investment trusts, infrastructure, hedge fund of funds, and commodities.[20] Such investment decision will mean leadership must be focused on the level of talent they have employed in their company's investment unit.

The profile of the portfolio may well vary across global boundaries, as some parts of the world (particularly in parts of Asia) have permitted more liberalization of investment options to boost exposures in non-mainstream investments.[21]

KPMG VIEW

- Throughout all of this diversity of investment, questions remain within the industry about just how much insurers will push in order to increase yield.
- There will be a need for pointed discussions within the executive suite and in boardrooms about limits on the levels and the types of investment in such alternatives as high-yield corporate bonds and certain commercial mortgage-backed securities, and emerging market debt, which are gaining in popularity but can carry high risks and capital changes.

[20] "Investment Themes for 2014 and Beyond," John Y. Kim, New York Life Co., KPMG Annual Insurance Conference, September 9, 2014

[21] Insurers Want More Alternatives Exposure," January 19, 2015, Institutional Asset Manager

Senior insurance executives and their boards will undoubtedly look closely at potential strategic M&A deals throughout 2015, given so many insurers have been hard pressed to sizably expand their core businesses.

In our view, the industry's very large levels of capital and surplus, in addition to ongoing shareholder pressure, could put more stress this year on large and midsized carriers to make strategic deals—many of which will be focused on taking advantage of alliances that will strengthen their technology transformation strategies.

Other than private equity firms acquiring the annuity businesses that life companies are shedding for strategic reasons, the pace of M&A in the life business continues to be relatively slow.

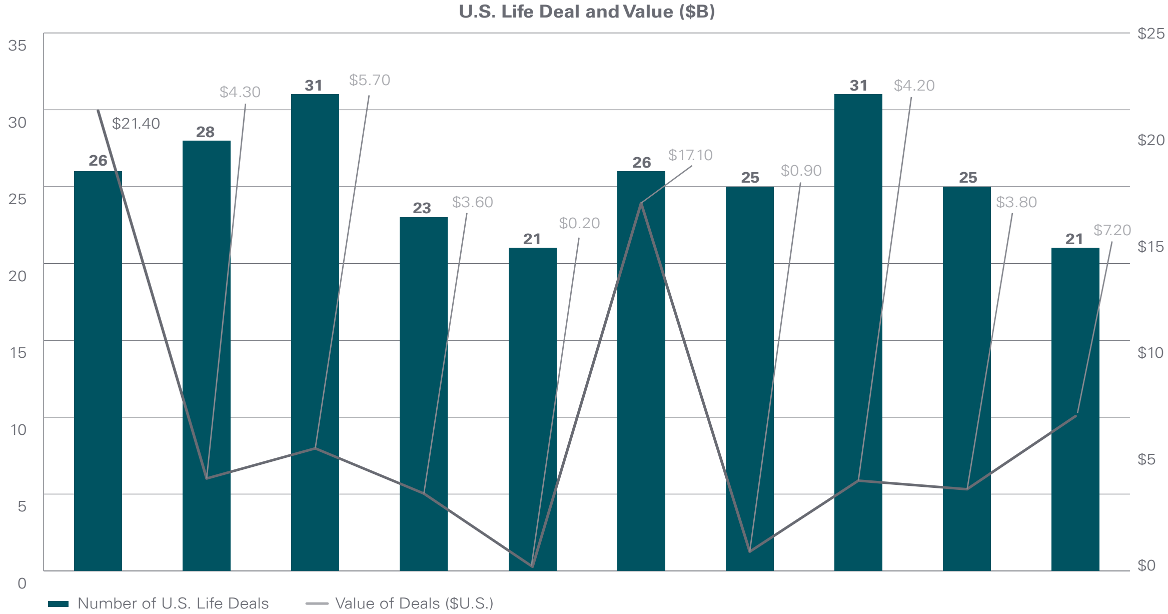
Still, KPMG's 2014 Insurance Outlook Survey showed that 54 percent of executives polled said they believed their company likely would be a buyer in the next 12 months. Although not all of the respondents were from life companies, the results suggest there is a hunger to grow this year and put excess capital to use.

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

(May not equal 100% due to rounding.)

Source: KPMG 2014 Insurance Industry Outlook Survey

U.S. Life Deal and Value ($B)



Source: SNL Financial; KPMG Research

At the end of 2014, performance metrics showed a mixed trend compared to prior periods. Price-to-earnings and price-to-book ratios for life stayed flat, reflecting the slowing down of the capital markets due to the uncertainty about the economy.

Capital and surplus levels in the industry, which exceeded $350 billion at the end of 2014, may very well provide a powerful stimulus to put at least some of that money to work to merge tech-savvy organizations, which might be able to provide scalability and agility, with some of the larger life insurers that already are struggling with tech upgrades.

KPMG VIEW

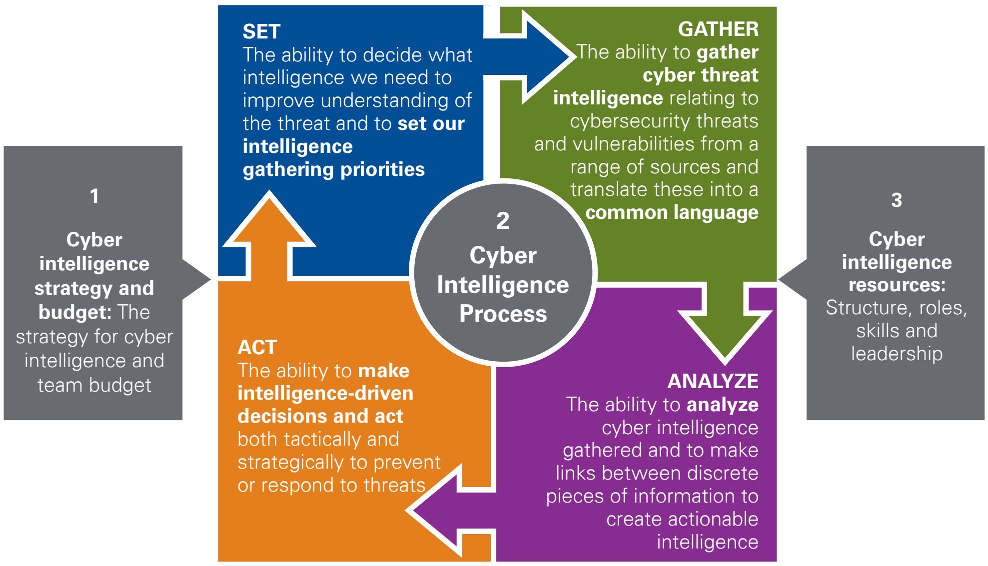
- The M&A lever may be pulled to help enhance much-needed tech applications in such critical areas as data and analytics. By joining with more nimble organizations with new-age technologies, more traditional insurers may also address another area of need: an upgrade in technology talent that can provide fresh thinking and ideas.

As the amount of data continues to grow exponentially, so does the rate at which organizations share data through online networks.

The implications relating to cybersecurity are enormous, as life insurers increasingly open their IT systems to a wider range of machines, the risk of losing direct control of data security continues to increase. Furthermore, any disruption to these core processes can have a major impact on service availability.

But it is a mistake to view this challenge only through the lens of technology.

Cyber Intelligence Process



KPMG VIEW

Cyber crime risks can be addressed. Life insurers can proactively take steps to protect their business, their reputation—and their customers.

Insurers can reduce cyber risks by building up capabilities in three critical areas—prevention, detection, and response.

Prevention

Prevention begins with governance and organization. It is about installing fundamental measures, including placing responsibility for dealing with cyber crime within the organization and developing awareness training for key staff.

Detection

Through monitoring of critical events and incidents, an organization can strengthen its technological detection measures. Monitoring and data mining together form an excellent instrument to detect strange patterns in data traffic, to find the location on which the attacks focus, and to observe system performance.

Response

Response refers to activating a well-rehearsed plan as soon as evidence of a possible attack occurs. During an attack, the organization should be able to directly deactivate all technology affected. When developing a response and recovery plan, an organization should perceive cybersecurity as a continuous process and not as a one-off solution.

Mistakes Can Be Costly

To many, cybersecurity is a bit of a mystery. This is probably one of the reasons why it is not always approached appropriately. From our years of experience, we have identified the five most common cybersecurity mistakes.

Number 1:

Mistake: **"We have to achieve 100 percent security"**
Reality: **100 percent security is neither feasible nor the appropriate goal**

Number 2:

Mistake: **"When we invest in best-of-class technical tools, we are safe"**
Reality: **Effective cybersecurity is less dependent on technology than you think**

Number 3:

Mistake: **"Our weapons have to be better than those of the hackers"**
Reality: **The security policy should primarily be determined by your goals, not those of your attackers**

Number 4:

Mistake: **"Cybersecurity compliance is all about effective monitoring"**
Reality: **The ability to learn is just as important as the ability to monitor**

Number 5:

Mistake: **"We need to recruit the best professionals to defend ourselves from cyber crime"**
Reality: **Cybersecurity is not a department, but an attitude**

Source: "The Five Most Common Security Mistakes: Management's Perspective on Cyber Security," KPMG LLP, 2014

Cyber Audit: An Essential First Step

In order to protect the insurance company, we suggest training of the current cyber staff and recruiting outsiders with long experience in cybersecurity and conduct a thorough security audit. There are certain fundamentals that may be considered prudent in order to assess vulnerability and help with making pricing decisions:

- Begin with a detailed plan and objective of the assessment.
- Boards and management should insist on regular inspections looking for IT vulnerabilities.
- Be certain that those who conduct the vulnerability review have demonstrated credentials in cybersecurity work.
- Involve people at the business-unit level in the assessment.
- After delivery of the risk-assessment report, act immediately to address the vulnerabilities.
- Build a formal security and procedure policy and establish education programs that involve all employees.

The audit must include high-level executives—the CEO, chief legal counsel, boards and high-ranking IT professionals. It is crucial to take a deep dive to discover cyber exposures. The meetings should focus on where (and how safely) the insurer's customer/ client data, and the business's own financial information and other sensitive intellectually property is stored.

Areas of consideration of risk include a solid understanding about the extent and usage of employee mobile devices that store and transport company information. Questions should be posed regarding whether the business uses cloud-storage strategies.

Greg Bell, KPMG's leader for cyber services and information protection at KPMG, recently suggested that the focus of attacks in the past was on such areas as theft of credit card numbers that were later sold. But KPMG has been tracking more cases involving destruction or modification of data as a means to simply disrupt and harm business activity.

The fallout of that kind of activity adds pressure to make significant changes to security culture at companies and to enhance training and education programs, clearly articulated response plans, increased threat intelligence capabilities, and buy-in from the board of directors. "As opposed to saying just deploy this new technology or new process, we really will have to think more broadly about whether we have the right strategy or approach," Bell said.[22]

[22] "CIOs and CISOs Can Learn From the Massive Sony Breach," The Wall Street Journal, December 5, 2014

REGULATION REMAINS A WILD CARD IN THE DECK

Uncertainty and scrutiny are two words that underscore the regulatory challenge life insurers are facing in the months, and perhaps years, ahead. Competing regulatory bodies, demanding steady streams of information, will continue to place stress on life insurance organizations.

In the months ahead, supervisors across the globe will continue their focus on capital and systemic risk. Whether it will be the designation as systemically important financial institutions (SIFI) by the U.S.-based Financial Stability Oversight Council or globally systemic important insurers (G-SII) designation instituted by the Switzerland-based Financial Stability Board (representing all "Group of 20" major economies), major life insurers face escalating scrutiny.

The issue left unanswered now and perhaps for all of 2015 is whether there will be more commonality in demands or whether the current air of uncertainty about expectations will persist. Further, there are questions concerning possible conflict among state and federal regulators that could impact existing internal reporting structures at life companies.

While these reporting demands will require investments in digitization, such as in data aggregation tools, data and analytics capabilities, and better enterprise risk management programs (ERM), it also will mean that insurance boards and management teams will need to confront cultural issues regarding resistance to change and the recruitment of new talent that can help streamline overall transformation effort relating to regulation.

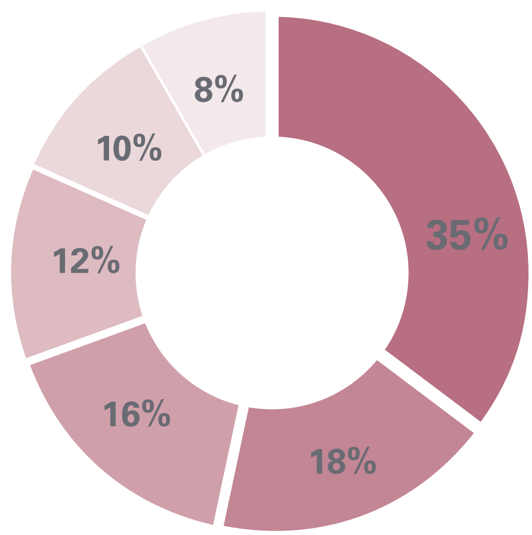
A Link to Strategy is Imperative

A successful transformation "involves aligning new business models with a risk strategy that complies with the volatile regulatory environment," says John Ivanoski, partner and national leader for the U.S. Financial Services Regulatory Practice at KPMG. "In other words, (insurers) that align their strategies and operating models with the regulatory framework will gain a competitive advantage. Product lines and geographies can be designed to maximize capital and optimize efficiencies."

A major concern in the coming year will be whether the increase in regulatory demands will throttle growth, due to the organizations having to spend so many costly resources (people, time, and funds) on the existing and pending rules.

Because regulators are going to place significant emphasis on governance, "one of the first areas they will want to understand is how the institution is managed, what the governance structure looks like, the documentation process, and the internal control structure," Ken Albertazzi, a KPMG partner in the Financial Services Regulatory Risk Practice, and a former Fed Supervisory Examiner, said during an insurance regulation panel discussion at KPMG's Insurance Conference in September 2014. "They want to understand where the risk is in the organization, and the extent that there is a robust ERM program in place."

Such demands will inevitably place enormous demands on the organization's data quality and data aggregation capabilities, which has been a struggle for many insurers, as noted in the following graphic – which comes from a recent KPMG survey of insurers that included the question: "What is the biggest challenge your company has faced in capturing data?'



Does not add up to 100% due to rounding

- Integrating data technology into existing systems and operating models
- The capacity to capture and integrate data from all areas of your business
- Data is incomplete or unreliable
- The ability to analyze the data once collected
- The ability to capture external data
- Identifying what data to collect

Source: "Digital Technology's Effect on Insurance Survey," KPMG International, May 2014

Regulatory Compliance Through Strategic Coordination

Because programs to comply with regulations are expensive to put in place, and they can limit revenue growth and profitability, we suggest that, in order to gain competitive advantage through a transformation, insurers need to design strategy and an operating model based on a regulatory framework by:

- **Recognizing that the regulatory framework is not only a trigger** for regulatory transformation, but also underlies transformations that can increase efficiency and profitability.
- **Embedding the regulatory framework in the operating model early on**, when possible, at the beginning stages of transformation. For best results, the regulatory framework should be considered while assessing the need for transformation or planning it.
- **Empowering compliance and risk executives in the process of transformation**, and securing companywide sponsorship for consideration of regulatory issues. The tone from the top should guide every single person in the organization to be conscious of risk management for both compliance and business purposes.
- **Establishing a system to track applicable regulations** and gather data for compliance, and gaining an understanding of how to turn regulations into a competitive advantage.

Source: "From Burden to Competitive Advantage: Regulatory Change and Transformation in Financial Services," KPMG, 2014

"A successful transformation "involves aligning new business models with a risk strategy that complies with the volatile regulatory environment ... "In other words, (insurers) that align their strategies and operating models with the regulatory framework will gain a competitive advantage. Product lines and geographies can be designed to maximize capital and optimize efficiencies."

– *John Ivanoski*
KPMG National Leader for U.S. Financial Services Regulatory Practice

VENTURE CAPITAL: NOTHING VENTURED, NOTHING GAINED

A closely related strategy to the M&A plays that we expect in the months ahead is the consideration of using venture capital (VC) strategies by insurers, leveraging their large surpluses and capital. Already, during the past several years, some of the largest insurers established VC units as a way to kick-start progress to acquire more market share. The idea is to use VC arms to embrace new technology in order to reach more customers that have eluded them and to find technology solutions that can help create greater efficiencies in their own businesses.

To be sure, creating VC teams is mostly aimed at assimilating new-wave technology in the core business of the parent, but it also is about acquiring talent that might never have considered the insurance industry as a place to launch a career.

These talented individuals and their ideas are needed for the industry to make great leaps in such diverse areas as building much more sophisticated underwriting models, and creating more touch points for customers.

During an October 2014 Webcast,[23] Ellen Carney, a Forrester Research Inc. principal analyst serving the insurance industry, reminded the audience that, with "their regular stream of premiums and irregular claims," the insurance industry is in an ideal position to fund new ventures. The demands by customers and shareholders to push insurers into more digital solutions ''are moving insurance venture funding from the shadows to the spotlight."[24] In a follow-up report, Carney wrote that "growing numbers of insurers are seeking to fund interesting start-ups … that promise to provide benefits to members and policyholders, transform the business of their parents, and keep their firms from stagnating."[25]

It is difficult to argue with that type of logic in this rapidly changing economic ecosystem. Indeed, businesses across the financial services spectrum are following suit: The Tabb Group, a financial markets research organization, reported a significant pick up in deals where traditional businesses were involved in "an inordinate number of billion-dollar venture backed deals."[26]

Such activity in the tradition-bound (and regulated) insurance industry, though, will require not only intense due diligence on the part of management and boards, but it also will mean that they will need superb risk-management skills.

> "With "their regular stream of premiums and irregular claims," the insurance industry is in an ideal position to fund new ventures."
>
> – *Ellen Carney, Principal analyst, Insurance, Forrester Research, Webcast on InsuranceTech.com, October, 2014*

[23] "Predictions in 2015: Trends in Digital Insurance Experience," October 21, 2014 – Forrester Research, https://webinar.insurancetech.com/17657

[24] Ibid

[25] "Predictions 2015: Venture Investments Will Spur Digital Insurance Innovation; Digital Disruption Promises New Threats and Opportunities in 2015." Forrester Research, October, 2014

[26] "2015: The Year of the Boutique Acquisition," The Tabb Forum.com, January 15, 2015

Our message to the industry is a straightforward one: Insurers that expect to thrive in the short and longer term in this highly competitive environment must pick up the pace of transformation and close the growing gap we see that separates the traditional insurers with digital disruptors.

With digitization, connectivity, and customer expectations rapidly changing, we suggest abandoning any "wait-and-see" attitude about change.

Insurers, which have long enabled the risk-taking culture of American commerce and have protected American household wealth, cannot dawdle in this period of transformation that hinges on rapid digitization.

Those that aren't prepared for this transformation risk disintermediation and irrelevance.

In our face-to-face discussions with board members and top executives in the insurance industry there almost always seems to come a point in the discussion when the topic turns to both the pace of transformation and the idea of linking the transformation to the organization's overall strategy.

While most of the industry leaders rightfully point out that their organizations have made great strides in the digitization of processes, operations, and even customer-outreach programs, we find that it is not uncommon for those executives to concede that their businesses need a more structured, strategically aligned plan for transformation.

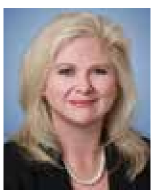
A major challenge is managing the broad scope and complexity of the transformation. That challenge is made even more difficult by the introduction of many new regulations, adding complexity and cost to the management of the business. Nevertheless, the only option we see is a commitment to moving forward with dispatch.

There is no question in our mind that secure, long-term, and sustainable competitive advantage demands a greater reliance on leveraging of new digital technologies to enhance the experience of existing customers and reach new customers. But, that leverage cannot be conducted in a vacuum. It must be done together with detailed, strategic thinking about the future needs of the customer and the future of the industry.

Silos that separate an organization's efforts to create and deliver products and services cannot be allowed to remain in place, and therefore must be knocked down through a transformative effort that is shared throughout each organization. There unquestionably will be winners and losers in this time of transformation: The question each insurer must confront is how well—and how quickly—they will carry out this critical change.

KPMG's Insurance practice is part of KPMG's Financial services practice, which is the largest provider of professional services to financial services globally. With our one firm approach, KPMG insurance professionals bring the best of the firm to help you meet your challenges. Our insurance professionals have deep knowledge about the issues affecting insurers today - from global regulatory reform to legacy platforms to customer-centric strategies.

Contact us:



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