



GLOBAL UPDATE

By Jennifer C. Rankin

While challenges abound in the post-financial crisis world, life insurers are facing them head on, rethinking their investment strategies, fine-tuning their individual products, entering and exiting product lines, bolstering their risk management capabilities—and more.



These are both promising and challenging times for life insurance companies around the world, which are coping with lower interest rates, adapting to evolving regulations and demographics, and leveraging emerging opportunities.

According to SwissRe, global economic growth was about the same in 2013 as in 2012, and still below long-term trends. Among the advanced markets, growth was strongest in North America, despite a slowdown in the U.S. Western Europe returned to slow growth. The emerging markets had a difficult year given still-weak demand from the advanced economies. Also, the announcement of monetary policy normalization by the U.S. Fed—that is, ramping down its quantitative easing (bond buying) program—sparked financial market turmoil, leading to weakness in emerging market currencies and equities. In contrast, advanced market equities rallied. By the year-end, long-term interest rates in the U.S. and U.K. were up by over 100 basis points from historically low levels at the end of 2012.

Industry Performance

Last year, global life insurance premiums written were US\$ 2.608 billion, with growth slowing to 0.7 percent from 2.3 percent in 2012, according to the most recent performance data for the global life insurance industry, which is published annually by SwissRe Economic Research & Consulting.

According to this year's report, *Steering Towards Recovery*, "Strong growth in Western Europe and Oceania was offset by a contraction in North America and stagnating sales in advanced Asia. Premiums contracted by 7.7 percent in the U.S. This was mainly because large corporate deals that had boosted group annuity business in 2012 were not repeated.

"In emerging markets, life premium growth improved to 6.4 percent in 2013. Growth was solid in Latin America and Africa, and resumed in China and India. In advanced countries, post-crisis average premium growth has been well below pre-crisis levels. In emerging markets the same is true in emerging Asia only. This is because of sharp declines in China and India coming after regulatory changes in both in 2011.

"Overall profitability has improved in life and non-life. However, it is still lower than in pre-crisis times even though non-life underwriting results have improved. Insurers' investment returns remain low given the low interest rate environment. Both the life and non-life sectors are well capitalized.

"Life premium growth is expected to resume in the advanced and improve in the emerging markets. The firming economy and labor markets in North America and Western Europe will support growth in life and non-life, and growth should hold up in emerging markets also.

In the life sector, China and India in particular could see notable strengthening in premium growth.”

This year, the global insurance industry is finally emerging from the combination of financial turmoil and economic uncertainty that has challenged insurance companies around the world for the past several years, according to *2014 Global Insurance Outlook*, which leading consultant EY recently published.

“Although it remains premature to unequivocally state that the difficult times are behind the industry, many signs point to significant pockets of opportunity. In Asia-Pacific, for example, rising individual wealth and aging populations are enticing areas of product expansion and revenue growth.

“Latin America continues to offer substantial growth potential to insurers that cleverly pursue specific niches. And in the United States, Europe and Canada, many insurers have rebuilt their capital positions in the wake of the financial crisis and are poised to wisely allocate it to competitive advantage and strength. All in all, the industry appears at the threshold of much better times ahead.

“Nevertheless, complex challenges lay ahead, chief among them the protractedly low interest rate environment. The question in 2014 is not how low rates may go, but how low they may remain. Another lingering challenge is the often-confounding array of stringent international and national regulations spawned by the financial crisis. Obviously, these enhanced regulations create significant compliance and governance burdens for insurers. Adding to these burdens is the implementation timing of many laws, which remains uncertain.”

Risk Factors

Despite today’s more promising economic climate, insurers face a number of high-level and industry-specific risks.

No company operates in a vacuum; in fact, a big part of every company’s mission, no matter what business it’s in, is identifying and crafting countermoves to potential environmental risks. The financial crisis of 2007-2008 and its lingering impacts have elevated the important task of risk management to an imperative.

One source of competitive intelligence on the risk topic is the World Economic Forum (WEF). Founded in 1971, the WEF is a Geneva, Switzerland-based nonprofit known best for its annual meeting in Davos, which brings together some 2,500 top business, political, and intellectual leaders to discuss pressing world issues and their potential impact on business, politics, society—and more.

The WEF surveyed more than 700 of these leaders to get their take on emerging global risks, publishing the results in *Global Risks 2014*, for which it collaborated with Marsh & McLennan, Swiss Re, Zurich Insurance Group, National University of Singapore, the Oxford Martin School of the University of Oxford, and the Wharton Risk Management and Decision Processes Center of UPenn.

In its preface, Klaus Schwab, founder and executive chairman, WEF, writes, “Transformational shifts in our economic, environmental, geopolitical, societal and technological systems offer unparalleled opportunities, but the interconnections among them also imply enhanced systemic risks. Stakeholders from across business, government and civil society face an evolving imperative in understanding and managing emerging global risks which, by definition, respect no national boundaries.”

From a list of 31 risks, survey respondents were asked to identify those they are most concerned about. According to them, the 10 global risks of highest concern are: fiscal crises in key economies; structurally high unemployment/underemployment; water crises; severe income disparity; failure of climate change mitigation and adaptation; greater incidence of extreme weather events; global governance failure; food crises; failure of a major financial mechanism/institution; and profound political and social instability.

So what do these high-level risks have to do with life insurance company performance? You’d be surprised. The most obvious impacts, of course, come from the financial system and its global interconnectedness. Who knew, for example, that derivatives, collateralized debt obligations, and other esoteric financial instruments would play such large

roles in bringing the world economy to its knees in 2008, eventually triggering central banking responses that have kept interest rates near zero, which, in turn, is making it extremely difficult for insurers to make a profit on many of their life insurance and annuity products?

In the WEF report, the Global Agenda Council on Fiscal Sustainability offers an excellent summary of how a high-level risk can make its way to the company level, using the No. 1 global risk cited by survey respondents—fiscal crises—as an example.

“Governments often run deficits, spending more than they raise in taxes. They make up the shortfall by selling bonds—borrowing money from private investors with the promise of repaying it, with interest, at a specified future date.” Corporations, of course, are big bond investors, as are financial product manufacturers, asset managers, and pension fund players—and insurance companies fall into all these categories.

As the report explains, “A fiscal crisis occurs when investors begin to doubt the government’s future ability to repay; the government then has to offer higher interest on its bonds to compensate investors for the increased risk. A vicious cycle starts: ballooning interest payments add to government debt, increasing the doubts of investors and forcing interest rates up still further. This can rapidly turn into a fatal spiral, in which fears that a country will default on its debt become a self-fulfilling prophecy.

“As government bonds tend to be held in substantial part by domestic banks, when the government defaults, the resulting losses on these bonds endanger banks’ solvency. In this way, a fiscal crisis can lead to financial crisis. The causation can also run the other way: the government may be forced to bail out large banks at risk of default to avoid a systemic financial crisis. However, the additional debt taken on can plunge the government from an already-precarious fiscal position into a full-blown fiscal crisis.

“Unsustainable debt developments ultimately force governments to undertake painful fiscal adjustments by cutting

expenditures and/or raising taxes. If such austerity is not timed well, it can trigger a deep recession and a strong increase in unemployment, a dynamic which has played out in many advanced economies since the financial crisis of 2007-2008.”

In Debt

According to the WEF report, advanced economies remain in danger of fiscal crises for several reasons. The U.S.’s official public debt is more than 100 percent of its GDP and Japan’s is more than 230 percent. The risks may be higher for Eurozone countries, which lack the option of devaluing their currencies to ease the necessary fiscal adjustments. Many emerging markets have seen credit bubbles in recent years that could turn into financial crises. A fiscal crisis in any major economy could easily have cascading global impacts.

As you can see, the financial system and its global interconnectedness pose risk. Chronic unemployment and growing income disparity—top risks in WEF survey respondents’ minds—also pose risk, especially to financial services companies. While the wealthy always have been important (and profitable) customers of said companies, many leading insurers also are targeting the middle class, which is large in U.S. and other advanced economies and growing rapidly in the emerging markets. It is this group of prospects, however, that is coping with high unemployment, rising costs for everything from health care to college, contract jobs (as opposed to jobs with health, 401(k) and other benefits), and the dismantlement of traditional safety nets such as corporate pension plans. It’s hard to sell insurance to someone without a job or someone who must choose between insurance and, say, paying the electric bill.

Earlier this year, billionaire investor Warren Buffet added public pension plans to his list of risk factors on which to keep an eye. In his annual letter to shareholders, he writes, “During the next decade, you will read a lot of news—bad news—about public pension plans.”

Public pension plans cover government employees. Many of these plans

Advanced Markets

NORTH AMERICA

Latest Data

Life premiums in North America were down 6.9 percent in 2013 after growing by 2.3 percent in 2012.

U.S. life premiums fell by 7.7 percent in 2013, partly because large group life and annuity corporate deals that had taken place in 2012 were not repeated (–1.6 percent excluding the deals). New business remained weak. Individual life new premiums declined as universal life products with death benefit guarantees contracted due to price increases and higher reserve requirements.

Meanwhile, individual annuity sales bounced back as rising interest rates supported fixed annuities. Term sales returned to modest growth and group life and disability recovered with improving labor markets. Capitalization remained solid, but low investment yields and weak sales challenged profitability.

In Canada, life premiums returned to growth in 2013 (+two percent), mainly on strength in the group segment. Individual life product sales were negatively impacted by re-pricing actions on universal life policies, while whole life products maintained robust growth. Individual annuity sales contracted for a fourth successive year. Fixed annuities gained from favorable interest rate and credit spread movements, but variable annuities with guarantees lost ground. Return on equity (ROE) hit the low double digits for the first time since 2008, but was still below the pre-crisis mid-teen levels.

Looking Ahead

U.S. premiums will return to growth in 2014 as the economy picks up. Profitability should improve but will remain below pre-crisis levels. Regulatory and profitability pressures will continue to push companies to shed unprofitable or non-core business.

Premium growth will remain below trend in Canada. Life insurers in Canada remain well capitalized, but uncertainty on regulatory capital requirements and proposals on regulatory capital requirements and proposals on revised accounting standards for 2018 may make companies more conservative.

Source: SwissRe Economic Research & Consulting

Advanced Markets

WESTERN EUROPE

Latest Data

Life insurance premiums in Western Europe grew by four percent to US\$ 926 billion in 2013, with large variations across countries. Premium income soared 52 percent in Portugal, and growth was also strong in Italy (+21 percent) and Sweden (+8.9 percent). In France, premiums grew 3.9 percent after two years of contraction and in the U.K.—the region's largest market—premiums recovered for a second-year running (+2.6 percent). In Greece, the market was down 13 percent, a sixth successive year of decline in a country with high unemployment and an ongoing recession. The Belgian market was weaker still, with premiums down 21 percent in both traditional and unit-linked business. Premiums also fell in Spain (-4.3 percent) and Norway (-3.1 percent). In Austria premiums declined by 2.2 percent but this was an improvement from the previous year's 9.4 percent slump.

Profitability in Western Europe improved slightly with life insurers benefiting from the stock market rally, but remained below pre-crisis levels due to low growth and low interest rates. Life insurers' capitalization continued to recover as financial markets improved. In Germany, the life industry is heavily exposed to low interest rates given its book of products with long-term and rigid guarantees. As a consequence, additional reserve requirements (Zinszusatzreserve, ZZR) were introduced in 2011 which accounted for US\$ 17 billion in 2013 (or 1.7 percent of technical reserves). The ZZR strengthens balance sheets but at the expense of current income.

Looking Ahead

The near-term outlook is subdued but improving. Weak economic growth and high unemployment in the region will continue to constrain demand for life insurance. Low interest rates and regulatory pressures are also impeding growth. However, there will be demand for savings and retirement products from a rapidly ageing population and as responsibility for retirement financing increasingly shifts to individuals.

Source: SwissRe Economic Research & Consulting

are underfunded, especially since the financial crisis, and many governments are struggling to meet their pension obligations to their retirees. A case in point is Detroit, which cited a \$3.9 billion deficit in its pensions when it filed for bankruptcy in July 2013. At the time, its emergency manager, Kevyn Orr, estimated that pension and retiree health care liabilities made up

half of the city's \$18 billion in debts. Struggling public pension plans have the potential to undermine local economies and the buying public if governments default on those obligations or raise taxes to cover them.

Rapidly aging populations around the world only exacerbate the problem. Social Security and other sovereign pension programs face similar funding

and performance problems. How this will affect retirees, communities, and the businesses that sell to both remains to be seen.

Another at risk group is young people—more specifically, those who, in 2013, were between 13 and 23 years of age. According to the WEF report, youth unemployment rates have soared since the financial crisis. In addition, jobs with long-term prospects—the normal situation for previous generations—have become scarce. “[Consequently] young people are vulnerable to being entrapped by either long-term unemployment or the inability to move on from low-quality and temporary or part-time employment.” Astonishing levels of student debt to pay college expenses only exacerbates their predicament. Again, the effects are unknown. Nonetheless, these are our future customers and the precariousness of their financial situation may not bode well for companies hoping to sell them insurance and other financial products.

Interest Rates

In addition to these and other broad risks, insurance companies face risks that are particularly relevant to their own industry. Among these are low interest rates and industry-specific regulations. Let's start with low interest rates.

It's almost impossible to overstate the effect low interest rates have on life and annuity companies. Since the financial and economic crisis started in 2008, global interest rates have been very low. This has severely affected insurance companies' revenues, given the approximately US\$ 27 billion of funds invested, according to SwissRe. In 2013, interest rates started to rise in advanced markets, particularly in the U.S. and U.K., and are projected to continue to increase over the next four years. Nonetheless, low interest rates are expected to linger in both as well as in Canada, the Asia-Pacific region and Europe.

Even when interest rates rise, however, the benefits take a few years to filter through to investment yields. Life insurance companies roll over only about

10 percent of their investment portfolios every year, according to SwissRe, so rising rates will have a marginal and delayed impact on investment portfolios over the next few years. So although interest rates are expected to rise, insurers must make decisions today to ameliorate the current subpar investment yield conditions.

Generally speaking, a prolonged low interest rate environment harms life and annuity companies in two ways. First, it reduces investment income. Second, it squeezes product margins. In response, some insurers are increasing risk in their asset portfolios as a way to get higher yields. In addition, many have taken a hard look at their product portfolios, repricing individual products and/or eliminating those they believe are too risky, too capital intensive, or have too meager a profit margin. They also are monitoring those products involving asset-based management fees, which have been unstable the past few years.

Leading consultant EY offers examples of the tactics some insurers are employing, among them:

- Increasing the fees on variable products to reflect the cost of hedging in the volatile economy
- Restricting investments that limit the amount of risk assumed by customers
- Repricing products and/or removing guarantees
- Creating new, more cost effective products
- Implementing automatic rebalancing to stabilize their fee income
- Restructuring investment portfolios to increase yield, including taking on more risk
- Forming captive reinsurance organizations, popularly known as creating captives

Insurers, then, are adapting to a new investment reality. When one thinks of asset management, companies such as BlackRock and Vanguard come to mind. It is important to remember that many insurers, in addition to being customers of asset management companies for the investments that underpin the pension, annuity and life insurance products they

Latest Data

Life insurance premiums in advanced Asian economies—that is, Hong Kong, Japan, Singapore, South Korea, and Taiwan) were flat in 2013 (–0.1 percent), after a strong increase of 7.6 percent in 2012. This was mainly because life premiums in South Korea dropped by 12 percent (2012: +29 percent) after the ending of a tax benefit hit sales of single-premium saving products. In comparison, protection products in South Korea continued to grow moderately. Life premiums were up 6.7 percent in Hong Kong and 4.8 percent in Singapore. In Japan, premium growth slowed to 1.4 percent from 4.1 percent in 2012 as sales of savings products were adversely affected by cuts in the assumed interest rate (AIR, guaranteed interest rate) in April 2013.

Profitability is estimated to have remained robust in the advanced Asian markets, supported by improving investment results. Tighter risk based capital (RBC) standards and rising interest rates in South Korea weighed on insurers' regulatory solvency margins, causing some life insurers to raise capital.

Looking Ahead

The life insurance sector is expected to keep up with steady growth in the advanced Asian economies. In Japan, sales of savings products will continue to be affected by the cuts in the assumed interest rate, but demand for health and medical products will remain strong. Insurance sales are expected to remain steady in Hong Kong and Singapore, but will be relatively weak in South Korea as the recent scandal over the leak of credit card information has resulted in a temporary ban on telemarketing activities. Telemarketing accounts for only a small share of distribution, but consumer confidence in South Korea has taken a hit following the leak.

Source: SwissRe Economic Research & Consulting

sell, have leading asset management arms themselves. Examples include Allianz (Germany), Aviva (U.K.), AXA (France), Great-West (Canada), ING (Netherlands), Manulife Financial (Canada), Old Mutual (U.K.), Principal Financial (U.S.), and Prudential (U.S.); another is Northwestern Mutual, which agreed, in June, to sell Russell Investments to the London Stock Exchange

Group. In addition, insurers have internal asset management organizations to invest the inflow of life insurance policy premiums, annuity contract deposits, pension plan contributions, and so on.

Investment Strategies

Known variously—and sometimes imprecisely—as asset managers, money managers and investment managers,

Advanced Markets

OCEANIA

Latest Data

In Oceania, life insurance premiums were up a strong nine percent in 2013, after declining by five percent in 2012. The turnaround was based on strong growth in Australia, where life insurers' investment-type business recovered and risk areas maintained steady growth. However, insurers' profitability was dented by higher lapses and claims, particularly in relation to group disability products. This was reflected in a 34 percent drop in after-tax profits for risk products in 2013. In New Zealand, life premium growth was flat (2012: +5.7 percent). Whole life, endowment and unbundled (unit-linked) traditional products continued on a downward trend, offsetting growth in critical illness (trauma insurance) and income protection products.

Looking Ahead

Life insurance is expected to sustain stable growth in 2014. In Australia, ongoing uncertainty about disability claims will continue to weigh on margins and interest in this line of business, even though premium rates have increased recently. At the same time, the sector faces an ongoing challenging regulatory environment. For instance, Australian life insurers are working through a sprawling array of regulatory changes, including a common regulatory capital regime (introduced on January 1, 2013), the Future of Financial Advice legislation (introduced on July 1, 2013) and the introduction of new regulations for superannuation entities (on July 1, 2013). In New Zealand, life companies face more stringent compliance and capital requirements.

Source: SwissRe Economic Research & Consulting

companies in the asset management industry manage the financial assets of corporate, institutional (such as pension funds), and retail (individual) clients. Major companies include U.S.-based Ameriprise, Axa, BlackRock and State Street as well as AMP Limited (Australia) and Old Mutual (U.K.). Most major banks also have asset management divisions.

According to Hoover's, demand for asset management services is driven by demographic and market trends such as the growing population of retirees and the accumulation of wealth and investable assets, as well as returns on

investments, which, of course, depend partly on economic conditions. Asset management services include portfolio management and investment advice. Firms use diverse business models and manage a variety of assets, including mutual funds, exchange traded funds (ETFs), pension funds, hedge funds and venture capital funds.

Asset management is a huge industry. According to *Asset Management 2020: A Brave New World*, a February 2014 report from leading consultant PwC, global assets under management (AUM) will rise from a 2012 total of US\$ 64 trillion to around US\$ 102 trillion by 2020.

Principal Global Investors, a diversified asset management organization that is a member of the Principal Financial Group, recently commissioned CREATE-Research, to survey the global investment landscape. In June, they released the results in *Not All Emerging Markets Are Created Equal*, a report summarizing the opinions of more than 700 pension plans, sovereign wealth funds, pension consultants, asset managers and fund distributors across 30 countries with combined assets under management of US\$ 29.7 trillion.

According to the report, institutional investors have become more discerning about investing in emerging markets as their economies reform at varying speeds. "Emerging markets are no longer seen as a homogeneous group," says Barb McKenzie, chief operating officer, Principal Global Investors. "Those identified as embracing a reform agenda are recognized as being more attractive. Survey respondents expect these economies to converge structurally and financially with developed economies in the near-term."

Nearly 35 percent of survey respondents believe China will deliver strong returns over the next three years, while on 15 percent believe Brazil can do so. Similarly, more than 50 percent of respondents believe China will make significant progress in implementing necessary economic reforms, whereas only six percent believe Russia can do so.

Marked volatility in emerging markets has caused institutional investors to shift from a buy-and-hold to a more tactical approach to emerging market assets. According to the survey, the percentage of investors that view emerging market assets as an opportunistic play has increased from 30 to 40 percent for equities and from 15 to 51 percent for bonds, since 2012.

Survey respondents view the U.S. as the key driver of the global economy over the next three years. Forty-seven percent of these investors believe the U.S. recovery will deliver the best returns. Nearly 65 percent believe the U.S. government will make significant progress in rebooting its economy.

Emerging Markets ASIA

Conversely, 30 percent of these investors think the outlook for Europe remains decidedly cloudy, with isolated pockets of revival expected only in Scandinavia and the U.K.

Themes emerging from the survey results, as viewed through the lens of investor segment, include:

- **Defined benefit plans.** Aging member demographics are driving the transition from asset accumulation to liability matching, with opportunistic investors looking toward distressed debt, emerging market equities, exchange-traded funds (ETFs), and emerging market corporate bonds.
- **Defined contribution plans.** Inadequate plan balances are intensifying the search for higher returns, with the most opportunity seen in ETFs and active equities and bonds.
- **Retail investors.** Consumers are becoming ultra-cautious as they approach or reach retirement and are focusing on cost, convenience and capital preservation when choosing investment products.
- **High-net-worth investors.** They are pursuing a range of goals, among them inflation protection and regular income via real assets as well as low volatility via balanced and capital protection funds.

Although financial markets and monetary policy are slowly normalizing, life insurers still face a host of challenges on the investment front. According to *Global Insurance Industry Outlook*, BlackRock's annual assessment of the most important trends affecting the industry, interest rates in much of the world will remain significantly below long-term average; the pressure to maximize value for shareholders (of non-mutual insurance companies) will remain intense; and the implementation dates of sweeping new regulations covering U.S. and European insurers are rapidly approaching.

In response to these challenges, BlackRock has identified the investment themes it believes will take shape this year and in the near future:

Latest Data

Life insurance premiums in emerging Asia—that is, China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam—grew by 4.1 percent in 2013 after flat sales in 2012. The improvement came on a turnaround in India with premiums up 0.5 percent after an 8.5 percent decline in 2012, and likewise positive growth in China (+3.1 percent versus -0.2 percent). Sales in both countries had previously been adversely affected by regulatory changes imposed in 2011. Other markets in the region reported robust growth, particularly the Philippines (+38 percent), Indonesia (+12 percent) and Thailand (+13 percent). The exceptionally strong growth in the Philippines was driven by sales of equity-linked variable insurance products. With respect to sector profitability, the low interest rate environment has weighed on profits in emerging Asia, while in China strong competition from wealth management products has also been a concern.

Looking Ahead

Life premium growth is expected to accelerate in 2014 as the recoveries in China and India pick up momentum. In India, improving consumer sentiment and financial market conditions should support demand for unit-linked and pension products. In China, tighter regulations on wealth management products and recent changes in bancassurance rules will likely boost overall insurance demand. However, the outlook will also be shaped by the direction interest rates take as this will alter the relative attractiveness of insurance and other financial products. In Southeast Asia, the very high average life premium growth rate of recent years is forecast to ease to a trend rate of around 10 percent.

Source: SwissRe Economic Research & Consulting

- **Income.** A “low for longer” fixed income environment will drive insurers to reevaluate and ultimately relax certain investment guidelines. Insurers will realign their investment portfolios in order to earn adequate income, provide principal protection, and deliver diversified sources of return while managing correlation risk.
 - **Profitability.** Pressure to enhance shareholder value will compel insurers to become more efficient in their capital deployment. In response to this pressure, insurers will adjust their product lines, operational processes, capital allocations and investment portfolios in order to improve efficiency and maximize profitability.
 - **Regulation.** Changes in global regulatory regimes will force insurers to refine their business and investment strategies. Capital deployment, asset allocation and risk management are all likely to be impacted.
- How are insurers responding to these challenges? For starters, they are broadening their use of exchange-traded funds (ETFs), says BlackRock. An ETF is a security that tracks an index, a commod-

Emerging Markets

LATIN AMERICA & THE CARIBBEAN

Latest Data

Life insurance premiums in Latin America and the Caribbean grew by 12 percent to US\$ 80 billion in 2013, down from 18 percent in 2012 but in line with the long-term trend. Brazil, Chile, Mexico and Argentina together account for 90 percent of the region's life insurance market, and all recorded weaker premium growth than in the previous year. In Brazil, strong premium growth in traditional life insurance lines offset a fall in the redeemable group life insurance, VGBL (Vida Gerador de Benefícios Livres). As a result, life premiums still posted strong growth of around 15 percent in 2013 (2012: +22 percent), despite the slowing economy. Faltering economic growth did, however, feed through to sluggish performance in Chile and Mexico where premium growth slowed to three percent and seven percent, respectively, from 19 percent and nine percent in 2012. In contrast, premium growth accelerated in Colombia, Panama and Peru, mirroring solid economic growth.

Looking Ahead

Tighter credit conditions, slowing economic growth, and rising inflation and joblessness in some countries are likely to weigh on savings and pension products in 2014, particularly in Brazil. Regulatory frameworks are being upgraded in several countries, which may act as a supply-side constraint in the short term. Brazil and Chile are implementing risk-based capital (RBC) frameworks and have applied for Solvency II equivalence. Mexico is currently conducting quantitative impact studies (QIS) for a Solvency II-inspired regulation to become effective in April 2015. Nevertheless, the regional life markets are expected to grow strongly in 2014 driven by a rebound in Mexico and stable growth elsewhere. Catch-up potential and increasing affordability of life coverage, both because of improved distribution and rising purchasing power, should continue to support demand over the longer term.

Source: SwissRe Economic Research & Consulting

ity or basket of assets like an index fund. It trades like a stock, does not have its net asset value (NAV) calculated every day like a mutual fund does, and has lower expense ratios than the average mutual fund. According to BlackRock, nearly 50 percent of insurers surveyed in 2013 intended to increase their use of ETFs.

In 2013, insurers also pursued a variety of innovative approaches to help manage annuity risk, according to the BlackRock report. "Tactics included de-risking guaranteed living benefit (GLB) [guarantees embedded into variable annuity products] by reducing benefit rates, suspending 1035 exchanges, cutting wholesaler commissions, managing sales through repricing, offering contract buy backs, developing and marketing investment-only variable annuity (IOVA) products, and pursuing focused investment options into risk-appropriate solutions." Many insurers also are adding more passive mutual fund choices to their variable products.

Regulation Matters

The recent financial crisis served as a wake-up call to governments around the world and they have responded with resolve and regulations. In addition, the globalization of business, which took off in a big way in the insurance sector in the early '90s, has compelled regulators to push for global solvency, accounting and reporting standards. Consequently, regulatory matters continue to consume the time, talent and capital of insurers around the world. The most pressing of these are:

- **ComFrame.** At present, the International Association of Insurance Supervisors (IAIS) is developing a group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a capital standard, which is being field tested this year. The final requirements are expected to be issued in 2018. The project is called "Common Framework for the Supervision of Internationally Active Insurance Groups" or ComFrame.

Emerging Markets

CENTRAL & EASTERN EUROPE

Latest Data

In Central and Eastern Europe (CEE), life insurance premiums declined by 3.2 percent in 2013 (2012: +5.6 percent). This was driven mainly by a sharp contraction in Poland, the region's largest market, where single premium business declined by 27 percent, as pure savings products (deposit products, which act as substitutes for bank deposit accounts) no longer benefited from a tax advantage on interest earned. Regular premium business in Poland stagnated but unit-linked business, on the other hand, continued to grow. In the other large life markets of CEE European Union (EU)-member states (Hungary, Slovakia, Estonia and Latvia), premiums rebounded while in the remaining EU-member countries, the contraction slowed or stabilized. Single premium business was the main driver for the recovery. In Russia, the boom continued, driven by credit-related products based on strong growth in consumer loans. Life premiums were up 47 percent in 2013, above the past three years' average. Premium growth remained strong in Ukraine and Belarus, and gained momentum in the Baltic states.

Looking Ahead

In the CEE EU member countries, particularly Poland, life insurance premium growth is expected to improve with further strengthening of the economy, falling unemployment and rising disposable incomes. In addition, insurance companies are increasingly focusing more on protection business, not the least because of the introduction of Solvency II. In Russia, on the other hand, consumption and credit growth are expected to lose further steam, which will affect growth of related life insurance products. At the same time, Russia has been quickly moving up the ranks and is now the third largest CEE life market, after Poland and the Czech Republic. This process is likely to continue, although at a slower pace, as penetration still remains very low at 0.1 percent. In the short term, the uncertainty around the Ukraine crisis will adversely affect growth in Russia, and a severe escalation and interruption of gas flows would likely also drag on the other CEE countries.

Source: SwissRe Economic Research & Consulting

- **Insurance Contracts.** Insurance industry representatives continue to weigh in on new accounting standards proposed by U.S. and international standard-setting entities that would significantly change how insurance contracts are reported on financial statements. In 2012, both the U.K.-based International Accounting Standards Board (IASB) and the U.S.-based Financial Accounting Standards Board (FASB) released exposure drafts of proposals for accounting of insurance contracts. The FASB and IASB proposals are part of a long term global effort to reach a unified accounting standard. The IASB's initiative is named International Financial Reporting Standards (IFRS 4 Phase II). FASB follows U.S. generally accepted accounting principles (GAAP). The IASB is expected to deliver the final IFRS4 Phase II standards sometime in 2015.
- **ORSA.** Insurers face growing regulatory pressures to improve their risk management practices. A major concept in play is Own Risk and Solvency Assessment (ORSA), which requires insurers to evaluate how much of their capital is subject to what risk levels and to submit written documentation to regulators. In some jurisdictions, the term ICAAP (International Capital Adequacy Assessment Process) is used to refer to ORSA initiatives. The IAIS has introduced a set of practices for enterprise risk management (ERM) that includes an ORSA requirement. In the U.S., there is the National Association of Insurance Commissioners (NAIC) ORSA initiative, which has an expected effective date of June 2015. In addition, Pillar 2 of Solvency II sets ORSA benchmarks. Finally, insurance regulators in various countries—among them, Malaysia, Singapore and Australia—have introduced ERM standards with an ORSA requirement. This year, Canadian insurers began to comply with the ORSA requirements set last year by the country's Office of the

Emerging Markets

MIDDLE EAST, CENTRAL ASIA & TURKEY

Latest Data

Life insurance premium growth in the Middle East, Central Asia and Turkey continued to be strong at 11 percent in 2013 rising to US\$ 6.3 billion, after a 12 percent increase in 2012. More than two-fifths of the 2013 increase came from Turkey, where premium volumes grew by 16 percent. In Saudi Arabia, life premiums are estimated to have increased by 4.2 percent after declining in each of the three previous years. In the United Arab Emirates (UAE), premium growth was also strong, up 18 percent. In Lebanon, premiums were up 18 percent in 2013 after declining 1.6 percent in 2012. On the other hand, volumes in Iran are estimated to have fallen 7.6 percent after strong double-digit growth in 2012. No information is yet available for other countries in the region.

Looking Ahead

In the medium-term, the region's life insurance market should benefit from an improving economic outlook, increasing insurance awareness, a high proportion of working-age population and rising affluence. Rising demand from the expat and increasing middle class population is expected to drive premium growth in the UAE. In Saudi Arabia, a mortgage law introduced in 2012 is expected to boost premium growth. The region's life insurance market has strong long-term potential because penetration rates are still very low.

Source: SwissRe Economic Research & Consulting

Superintendent of Financial Institutions (OSFI). In addition to these regulator-driven ERM schemes, insurers have their own longstanding ERM processes.

- **Solvency/RBC.** Rigorous solvency requirements are unfolding across the world. These include Solvency II in the European Union, various risk-based capital (RBC) regulations, and higher capital requirements in general. The IAIS intends to develop a risk-based global insurance capital standard by the end of 2016. Full implementation is scheduled to begin in 2019, after two years of testing and refinement with insurance supervisors and IAIGs. In October 2013, the

implementation date for Solvency II was formally delayed until January 2016. Singapore is expected to implement second-generation RBC regulations by year-end and Hong Kong is expected to implement higher RBC standards between 2016 and 2017, according to EY. "Other countries are moving closer to a three-pillar Solvency II-style approach. For example, China's second generation insurance solvency regulatory regime, which is to be implemented by 2016, follows Solvency II's three pillars of quantitative capital requirements, qualitative controls and reporting/market discipline. Thailand, which introduced RBC recently, is now considering

its second generation RBC requirements." Mexico is leading the way in Latin America, having set a 2015 compliance date for a Solvency II-style capital requirement framework.

- **Systemic Importance.** The world's largest insurers are grappling with the possibility of receiving systemically important financial institution (SIFI) and/or global systemically important insurer (G-SII) designations, which carry enhanced regulatory reporting and capital requirements. Last year, several insurers received these designations. In the U.S., the Financial Stability Oversight Council established under the Dodd-Frank Act of 2010 designated American International Group (AIG) and Prudential Financial as non-bank SIFIs and is evaluating MetLife as a prospect. In addition, the Financial Stability Board established by the G20 nations designated nine insurers—AIG (U.S.), Allianz (Germany), Aviva (U.K.), Axa (France), Generali (Italy), MetLife (U.S.), Ping An (China), Prudential Financial (U.S.) and Prudential(U.K.)—as G-SIIs. Going forward, the list of G-SIIs will be updated every November, starting this year.

Complying with all of these regulatory initiatives will be demanding. "Many companies will need to provide considerably more risk information and explanation to meet the more exacting analyst expectations that have resulted from market events," according to the PwC report. Nonetheless, doing so, say proponents, may open up cost-savings synergies as well as strengthen stockholder confidence. Regulatory compliance also will compel insurers to improve their modeling capabilities, data quality, data governance, and the level of detail provided in their reporting and modeling systems. Multinational insurers face not only the complexity of cross-border supervision and regulation, but also the possibility of conflicting requirements as various regulators, jockeying for control, issue overlapping mandates. Finally, all insurers will need to adjust their asset allocations and risk management processes as new regulatory requirements go into effect.

Opportunity Knocks

Despite these challenges, insurers are well positioned to take advantage of demographic changes that are occurring around the world—a growing middle class, rising individual wealth and global aging, in particular.

In the Asia-Pacific region, for example, the continuing increase in middle-class and high-net-worth consumers is highly favorable for the insurance industry. EY expects the Asia-Pacific region's share of the global middle class to nearly double, rising from 28 percent in 2009 to 54 percent in 2020. "The increasing individual wealth and aging population will create opportunities for insurers to introduce new products to consumers that protect their hard-earned financial and physical assets."

Europe's aging population will drive demand up for retirement products. In the Eurozone alone, 20 percent of the population is over 65 years of age and an increasing number of citizens are approaching retirement every year. In the U.S., more than three million Baby Boomers will reach age 65 in 2014 alone. Canada also will have a big wave of retiring Baby Boomers over the next several years. These aging populations are a mixed blessing. While they drive demand for asset management and annuity products, they place a huge strain on social security systems, most of which are underfunded. And because they are beginning to withdraw money from their retirement accounts, insurers must make payouts to them at a time of slow growth and low investment yields. Nevertheless, retirees offer a big opportunity for product innovation. EY believes insurers should look to post-retirement product needs, hybrid products and products for working retirees.

In its report, *Insurance 2020: Turning Change into Opportunity*, PwC cites many opportunities for insurers selling life insurance, annuities and retirement products. The first of these is new products for seniors. "An ageing population in most developed countries will result in new growth opportunities in drawdown or retirement income products, long-term care products and longevity insurance."

Another growing opportunity is managing retirement portfolios both before and after retirement.

PwC also believes insurers will step onto government turf. "The increasing dependency ratio in most developed countries (and China) will increasingly strain government support for the elderly and sick. This could open up the opportunity for insurers to form public and/or private partnerships to offer value-added solutions in response to a political

challenge. Finally, there is opportunity in the realm of tailored products.

As you can see, life insurance companies around the world have their work cut out for them. They must make smart moves in the face of economic, regulatory, and accounting uncertainty. They must find ways to tap into the promising growth markets in their own back yards and consider the possibilities abroad. As they do just that, *Resource* will keep you apprised. ♦

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