GLOBAL UPDATE

Another Challenging Year

By Jennifer C. Rankin

Insurers everywhere are carefully monitoring developments in the global economy, regulatory oversight, promising markets, and more—then positioning themselves for success in a post-financial crisis world.

It has been another challenging year for the global life insurance industry, which is coping with stalled economies, touchy equities markets, low interest rates, evolving regulations and demographics, and more.

Let's start with the macroeconomic climate. While much improved since the 2008 global financial crisis, the economic environment for insurers improved only marginally in 2014, with global real gross domestic product (GDP) rising by 2.7 percent, according to SwissRe. "The improvement was driven by the advanced markets, led by the U.K.," according to the reinsurer. "Growth in the U.S. accelerated slightly to 2.4 percent and was also stronger (but uneven) in Western Europe. In Advanced Asia, growth slowed due to ongoing sluggishness in Japan. In contrast, the emerging markets grew at a slower aggregate rate of 4.1 percent in 2014, down from 4.6 percent in 2013. Many countries struggled with domestic difficulties, structural deficiencies and uncertainty about the impact of the U.S. Federal Reserve cutting back its quantitative easing program. Advanced countries' equity markets outperformed their emerging market peers and government bond yields remained very low."

Economic Environment

Numerous forces shaped the 2014 economy and many continue their influence today. These include:

- **Geopolitical tensions.** A good example is Central and Eastern Europe (CEE), where growth in 2014 was held back by tension between Ukraine and Russia, with the latter annexing the Crimean peninsula in March 2014. In response, various countries have placed sanctions on Russia, hurting its exports and investor confidence in the region as a whole.
- **Central bank policy.** In October 2014, the U.S. Federal Reserve ended its quantitative easing (QE) program, making its final US$ 15 billion of monthly bond purchases, which were made in an effort to keep the economic recovery going after the 2008 global financial crisis. Though it ended the bond buying program, it has yet to raise interest rates, which, at present, continue to be close to zero. The Bank of England (BoE) also scaled back its expansionary monetary program. Other countries are dialing up or maintaining their efforts. The Bank of Japan (BoJ), for example, has embarked on enhanced quantitative and qualitative easing in an attempt to reach the desired level of inflation; it has had limited success, so economic growth in Japan is likely to remain sluggish. Another example is China, which continues to adjust fiscal and monetary policy to prevent an economic hard landing. A third is the European Central Bank (ECB), which launched quantitative easing in early 2015. The success—or failure—of central bank policies affects capital markets, which are increasingly interrelated and global in nature. The capital markets, for example, have been, and continue to be, increasingly volatile as they absorb the QE programs of various countries and wait for the U.S. to raise interest rates.
- **Interest rates.** It's almost impossible to overstate the effect low interest rates have on life-annuity companies. Since the financial crisis, global interest rates have been very low. They are projected to rise, but the timeframe continues to be pushed back. And when they do rise, it will take a few years for the benefits to filter through to investment yields. Generally speaking, a prolonged low interest rate environment harms life-annuity companies in two ways. First, it reduces investment income. Second, it squeezes product margins.
- **Greece.** Last year, the left-wing Syriza movement came into power and has, since then, tried to renegotiate the terms of the country's roughly 240 billion euro (US$ 264 billion) bailout by creditors—dubbed the troika, they are the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Commission (EC). On June 30, Greece failed to make a scheduled debt repayment of 1.5 billion euros to the IMF. On July 5, Greeks voted a resounding "no" to a referendum asking them to accept austerity measures in exchange for a continuing monetary lifeline from its creditors. Shortly thereafter, Greece closed its banks and stock market. On July 13, Prime Minister Tsipras struck an agreement with other European leaders, the terms of which give Greece its third bailout of US$ 96 billion and easier repayment terms on some of its existing debt in exchange for austerity measures that include pension cuts and tax increases. He must win legislative support for the deal. If Greece goes bankrupt and/or leaves the eurozone, analysts do not expect any sort of major financial markets contagion. They do, however, warn that Greece is linked to the world financial system in ways that may not become evident until a collapse, especially in Europe.
- **Sovereign debt.** Greece is not the only country with an untenable debt load. In fact, at press time, Puerto Rico had just announced to the world that its debt was "not payable." Ukraine is moving closer to default on its debt load. Globally significant economies such as Brazil, Turkey, Italy and China have stifling debt loads. According to New York Times reporter Peter Eavis, central banks around the world have spent US$ 10 trillion in recent years to stimulate their economies and fight financial crises.

The equities markets are reacting negatively; when Greece closed its banks, for example, "Wall Street's avidly watched fear gauge, known as the Vix, spiked to its highest levels in months, suggesting more turbulence ahead," writes Eavis. The stock markets of Italy, Portugal, Spain and China fell simultaneously. "The return of nervous selling on stock markets raised important questions about the health of the global economy," Eavis concludes.

- **China.** For several years now, China has been the world's leading economic growth engine. Recently, however, that growth has slowed. The Shanghai Composite lost 24 percent of its value during the last two weeks in June, compelling China's 21 largest brokerage firms to pledge more than US$ 19 billion in stock purchases to try to stabilize the market, according to CNN. Although the exchange is still up 14 percent this year, the market has been exceptionally volatile this year and, according to Oxford Economics, could fall another 35 percent before things settle down.
- **Tax reform.** Life-annuity companies around the world face the constant threat of unfriendly tax law, especially as local governments search for new sources of income in tough economic times. Sometimes tax law helps the consumer, but hurts the insurance industry. A good example is the U.K., where the existing 55 percent tax rate on pension savings passed on to beneficiaries was abolished this past April, making annuities less attractive to retirees. As a result, "annuity providers, already suffering from the scrapping of compulsory annuities in the country's March 2014 budget reforms, face extra pain," according to EY's *2014 Global Insurance Outlook* report. Global players also are targets because of continued global pressure to put an end to tax shifting strategies. Leading the charge is the ongoing Organization for Economic Co-operation and Development (OECD), whose Base Erosion and Profit Shifting (BEPS) project is half complete. According to EY, its proposals include "a requirement to report revenues, taxes paid and head-count for every jurisdiction in which business is carried out; limitations on the tax deductibility of interest on debt and hybrid regulatory capital; lowering of the threshold for creating an offshore taxable presence; and restrictions on the deductibility and pricing of intragroup reinsurance." G8 and G20 governments have endorsed this project and have committed to individual country action. Major developing (non-OECD) countries, including China and India, are participating in the BEPS project as well. In addition, an unexpected decision by the Court of Justice of the European Union in the Skandia case in September 2014 means global banks and insurers operating in the U.K. and elsewhere in Europe now face extra value added tax (VAT) bills. Affected companies were previously VAT free and now face tax rates between 15 and 27 percent for cross-border transactions. "As insurers are typically not able to recover their VAT costs, this additional amount would give rise to a significant above-the-line cost," according to EY.
- **Employment.** When unemployment falls, domestic consumption rises. Last year, for example, the U.K.'s real GDP growth was the highest of the advanced economies, due, in large part, to lower unemployment, according to SwissRe. On the other hand, Euro area unemployment remains at near record highs and "the economic recovery continues to be a jobless one for many Europeans."

In addition to these—and other—macroeconomic challenges, life-annuity companies face complex and evolving regulations.

Regulatory Pressures

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. 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.
- **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 this year and could require compliance by 2018 or 2019.
- **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 went into effect in January. 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. In 2014, Canadian insurers began to comply with the ORSA requirements set by the country's Office of the 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. Among the countries implementing second-generation and/or higher RBC standards by 2017 are Singapore, China, Hong Kong, Thailand and Mexico.
- **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 has designated American International Group (AIG), Prudential Financial and MetLife as non-bank SIFIs. In addition, the Financial Stability Board established by the G20 nations has designated nine insurers—AIG (U.S.), Allianz (Germany), Aviva (U.K.), Axa (France),

Advanced Markets NORTH AMERICA

Latest Data

U.S. life premiums fell by an estimated 2.5 percent in 2014 as sales of group annuity business with guaranteed interest suffered from lower guarantee rates. This was an improvement over 2013, when they fell 7.6 percent. The individual annuities business strengthened and group life premiums returned to positive, but low, growth. Individual life premiums were flat despite employment gains. Re-pricing to account for lower interest rates and low experienced lapse rates continued to affect universal life (UL) sales. Term sales also fell, pressured by a lack of real wage growth. U.S. life insurers' balance sheets remained solid. Weak sales and low investment yields challenged profitability, but income from alternative investments and fees from rising equity markets both increased. Most companies remained well capitalized and continued to distribute earnings back to shareholders.

In Canada, life premium growth improved to 3.5 percent in 2014. Group product sales were strong and growth was also aided by a first year of low positive growth in individual annuities after four years of contraction. UL sales supported growth, while whole life sales slowed and term products contracted. Despite a step down in interest rates, life insurers' return on equity (ROE) improved slightly, but was still below pre-crisis levels. The sensitivity of profits to interest rates has decreased in Canada's life sector because of repeated pricing actions and product repositioning, along with an increased focus on hedging.

Looking Ahead

In the U.S., growing employment and consumer spending will support demand for life insurance in 2015, but growth will likely fall short of the long-term trend. Interest rates are expected to rise but will remain low, adversely affecting profitability. Also, downside risks from higher financial market volatility have increased.

In Canada, premium growth is projected to slow slightly this year along with the economy, but should revert to trend in 2016. Profitability is expected to remain in low double digits. The new regulatory capital framework due to come into effect in 2018 is likely to keep companies conservative on capital deployment for the time being.

Source: SwissRe Economic Research & Consulting

Advanced Markets
WESTERN EUROPE

Latest Data

In Western Europe, life insurance premiums grew by 5.8 percent in 2014, the highest growth rate since 2007. Premium income developed favorably in most countries, driven by strong sales of savings-type products. Premium income continued to soar in Italy and Portugal (+23 percent and +13 percent, respectively), and was also strong in Luxembourg, Greece, Norway, Sweden, Ireland, Belgium and France. Premium growth was moderate in Germany (+2.3 percent) and Switzerland (+1.1 percent), and returned to a positive territory in Austria (+2.3 percent) after four years of contraction. In the U.K.—the region's largest market—premiums stagnated. Premiums in the Netherlands continued their steep decline for the third year in a row (–11 percent), with individual life sales remaining week. This was driven by a move to tax-advantageous bank savings products and also low consumer trust in life products.

Profitability in Western Europe remained stable during 2014. Life insurers benefited from investments in less liquid assets and from stronger stock markets. In the U.K., equities are an important part of U.K. life insurers' asset allocation and their profits duly surged. Western European life insurers' capitalization continued to recover. This mirrors solid business operations and strong profits, but also a renewed decline in interest rates. Low interest rates continue to be a major challenge for life insurers. The most exposed are insurers in Germany, the Netherlands and Norway given the high prevalence of products with long-term and rigid interest-rate guarantees.

Looking Ahead

The near-term outlook is subdued. Sluggish economic growth and high joblessness will continue to constrain demand for life insurance. However, there will be demand for protection, savings and retirement products given a rapidly aging population and as responsibility for retirement financing increasingly shifts to individuals. Growth will again decline and level off at about 2.5 percent in real terms in the next years.

Source: SwissRe Economic Research & Consulting

Generali (Italy), MetLife (U.S.), Ping An (China), Prudential Financial (U.S.) and Prudential (U.K.)—as G-SIIs. The list of G-SIIs now is updated every November.

- **Product Sales.** Europe is a good example of the scrutiny that regulators are giving to sales practices. By 2017, life-annuity companies in the region must comply with the second Insurance Mediation Directive (IMD2), the Packaged Retail Investment Products (PRIPS) initiative, and the second Market in Financial Instruments Directive (MiFID2). According to EY, "IMD2, which is currently the subject of discussion among the European Commission, European Parliament, and European Council, provides local regulators with the option of banning commission payments. It also includes specific requirements on product oversight and governance, and is therefore likely to create significant changes to product and sales procedures and controls going forward. Taken as a whole, these European regulatory initiatives require greater transparency in terms of the information provided to customers, revisions to relationships with distributors, and greater governance and oversight over new and existing products." Europe is not alone. Recent problems with Hong Kong investment-linked assurance scheme (ILAS) has compelled regulators to require disclosures regarding distributor pay, product fees and charges, and investment risk factors. Concerned regulators in both Singapore and China are now auditing insurance sales and compliance practices. Also tightening sales supervision is India's IRDA, which recently mandated commission limits.

Complying with all of these regulatory initiatives is very demanding from an operational and cost standpoint. In addition, there are overlapping mandates from different regulatory bodies, which often are in conflict and/or competition with each other. Multinational insurers face not only these challenges, but also the complexity of cross-border supervision and regulation.

Good News

As you can see, life-annuity companies face a great deal of economic and regulatory pressure. Despite this, there are dozens of positive trends of which they are taking advantage—and from which they are profiting.

The first of these is demographics. Many population segments are growing, some quite rapidly. These include the high net worth, middle class, young adult (Generations X and Y), and senior (age 55+) segments. Each of the segments has protection and savings needs that life and annuity products are designed to meet. At present, life-annuity companies, banks and brokerages are giving a great deal of attention to the retirement needs of aging populations around the world. This is a big and growing market—25 percent of the U.S. population, for example, is 55+ years old. Underserved market segments beckon as well. Most analysts agree that the middle class population is underserved and that there's much opportunity to be tapped.

Another positive trend is the consumer's embrace of technology and multiple touch points. Huge swaths of customers worldwide have personal computers, smart phones, smart watches, iPads, iPods, and more. They are on Facebook, Instagram, Twitter and other social media platforms. They want 24/7 access to their financial services providers and multiple purchase avenues. In fact, 80 percent of customers worldwide are willing to use digital and remote contact channels for different types of interactions with their insurers, according to EY's *2014 Global Consumer Insurance Survey*. Life-annuity companies are responding with a big marketing presence on social media platforms and an omni-channel approach to sales. While agents, who sell face-to-face, continue to be a robust and effective sales channel, many companies are adding bancassurance partnerships, direct marketing, and robo-advice platforms to the mix. The more ways one can reach the customer, the more opportunity there is to make a sale.

A third positive trend is the loosening of restrictions on entry into foreign markets. Historical obstacles to entry took the form of restrictions on foreign ownership and allowable investment classes. An example is India, where foreign insurers traditionally could own just 26 percent of a local insurer, a cap the Insurance Regulatory and Development Authority (IRDA) recently raised to 49 percent. Another is China, where the China Insurance Regulatory Commission (CIRC) now allows investors to take an ownership stake in more than one insurance company if those companies sell similar products.

Advanced Markets
ASIA

Latest Data

Life insurance premiums in the advanced Asian markets—that is, Hong Kong, Japan, Singapore, South Korea and Taiwan—returned to growth in 2014, up 4.5 percent after a 6.4 percent decline in 2013. This was mainly due to a recovery in South Korea (premiums up 6.3 percent), where there had been a significant slump the previous year due to the termination of tax benefits and consequent fall in sales of single premium saving products. Premium growth in Taiwan increased to 6.3 percent in 2014 from 3.2 percent in 2013, due to sustained demand for variable annuity and variable life insurance products. In comparison, Hong Kong and Singapore both reported more tempered but still respectable growth. In Japan, the cuts in the assumed interest rates in April 2013 resulted in a tangible contraction in individual life business that year, but the negative effect dissipated in 2014. Total life premiums growth was 3.3 percent last year after an 8.1 percent decline in 2013.

Life insurers in advanced Asia continued to report good profits in 2014, supported by stable investment results. Insurers have increased their overseas exposures, particularly to the U.S., to improve return on investment. The reduction in assumed interest rates in Japan and strong inflow of new business in Taiwan helped contain insurers' cost of liabilities. South Korea, however, is exposed to negative spreads, with guaranteed interest rates below market rates.

Looking Ahead

Insurance demand is expected to remain flat in Japan in the near term alongside rising wages and household income. The demand recovery in South Korea will continue into 2015 but at a modest pace, given weaker economic momentum and lower interest rates. Hong Kong and Singapore will also likely see slower growth because of a more challenging economic backdrop.

Source: SwissRe Economic Research & Consulting

Advanced Markets
OCEANIA

Latest Data

In Oceania, overall life insurance premium growth was strong at 27 percent in 2014, up from 9.3 percent in 2013. The surge was mainly due to strong growth in Australia (+28 percent), where life insurers' investment-type business gained from stronger equity markets. Australian life insurers' after tax profits improved by 23 percent in 2014, and the industry's capital base remains very strong. In New Zealand, total life premiums grew by 2.8 percent in 2014, an increase over the 2.3 percent growth the country experienced in 2013. By product, growing sales of trauma insurance and income protection-type products was partly offset by a continued decline in sales of whole life, endowment and unbundled traditional products.

Looking Ahead

The life insurance industry is expected to sustain moderate premium growth and steady profitability in 2015. In Australia, steep increases in group risk insurance premium rates should support underwriting profits, but worsening claims and lapse rates remain a concern. Meanwhile, life insurers will continue to adjust to regulatory changes such as the Future of Financial Advice (FOFA). At the same time, the

Stronger Super reforms remain a focus as life insurers become increasingly integrated with financial/wealth management businesses. In New Zealand, life companies are facing increased compliance and capital requirements. In December 2014, for example, the Reserve Bank of New Zealand amended the definition of capital and tightened solvency requirements on guarantees and reinsurance.

Source: SwissRe Economic Research & Consulting

When barriers to entry loosen, cross-border transactions grow. Recent examples include Fosun's acquisition of Caixa Seguros in Brazil, Oris's acquisition of Hartford Life, and Dai-Ichi Life's acquisition of Protective Life.

These positive demographic, technological, and regulatory trends—coupled with a comparatively steady economic climate and emerging product opportunities—have resulted in an upswing in merger and acquisition (M&A) activity in the life-annuity sector.

M&A activity took a nosedive in 2009, when the financial crisis was at its peak, and has been in the doldrums since then, due to the subsequent global economic downturn. The current upswing is modest, but growing. In the recently published report *M&A Insurance: Start of a New Wave?*, SwissRe researchers examine this upswing, finding that M&A activity has been "segment-specific rather than industry-wide. Some key themes in recent insurance deals include divestments of closed blocks [of business] and run-off operations. Such disposals can be an effective way to achieve early exit from business in run-off so that capital may be redeployed to new or expanded lines of business. Other themes include a number of M&As involving insurers from emerging markets, particularly Asia Pacific and Latin America."

Various industry surveys suggest M&A is appealing again as insurers adjust to lower profitability post-crisis and, as a result, look for growth opportunities and/or improved capital positions. And although M&A activity has remained significantly below pre-crisis levels, SwissRe notes there were 295 M&A announcements in the first half of 2014, followed by 359 in the second half, among them U.K. life insurer Aviva's takeover of Friends Life.

According to SwissRe, the motivation behind these recent deals varies. "In Europe and North America, financial distress and the need to strengthen balance sheets prompted numerous forced and strategic divestments. In Japan, poor growth prospects at home motivated companies to expand their footprint in other advanced markets and in emerging economies in the region. In emerging markets, M&A activity has been rising in recent years driven by regulatory reforms and the strong growth potential, which has attracted foreign buyers from mature markets. Meanwhile, some large global players have stepped up efforts to grow their asset-management arms via acquisitions of retirement plan services in order to diversify income streams—in the U.S., for example, Great-West acquired JP Morgan's Retirement Plan Services and Manulife acquired New York Life's Retirement Plan Services." More specifically:

- **Forced divestment.** During the financial crisis, some life insurers suffered severe stress and accepted government assistance. According to SwissRe, they have driven some of the largest deals in the post-crisis period. In Europe, the European Commission imposed restructuring plans on bancassurers that received state aid, forcing them to divest their insurance operations—ING, for instance, sold its insurance and pension operations in Latin America to an investor group. In the U.S., AIG had to restructure and divest some its insurance operations to repay government bailout dollars, selling ALICO to MetLife and two Japanese insurers to Prudential Financial.
- **Strategic repositioning.** Post-crisis, a number of European and North American life insurers sold non-core and annuity units and exited markets where performance had not met expectations. In addition, a number of Canadian and European life insurers—among them, Sun Life, Manulife, Industrial Alliance, Aviva, Generali, Aegon and Old Mutual—sold various U.S. operations. Financial conglomerates such as ING, HSBC, BBVA and Santander have retreated from bancassurance to concentrate on core banking operations.
- **Financial buyers.** After the financial crisis, private equity and hedge funds became new buyers of blocks of life-annuity businesses, mostly in the U.S., but also in the U.K. The major U.S. players include Athene, Guggenheim, Global Atlantic Financial Group (which consists of Goldman Sachs and various investors), Prosperity Life Insurance Group (which consists of Reservoir Capital and Black Diamond Capital Partners), and Harbinger Capital Partners. Many financial buyers are focused on purchasing blocks of savings businesses and then using non-tradition investment strategies to boost returns. Among these financial buyers are so-called specialist consolidators who focus on liability management,

Emerging Markets
ASIA

Latest Data

Life insurance premium growth in Emerging Asia—that is, China, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam—accelerated to 9.9 percent in 2014 from 3.3 percent in 2013. The strong performance reflected a recovery in China (+13 percent) driven by new distribution channels such as internet sales, a recovery in bancassurance and lower surrenders. Elsewhere in the region, growth remained strong in Thailand (+12 percent), the Philippines (+13 percent) and Vietnam (+13 percent). In Indonesia, life insurance premium grew by just 3.1 percent as sales of investment-linked products began to level off following years of strong growth. In India, premium growth improved from 2013 (–0.2 percent) but remained weak at one percent, reflecting sustained weakness in sales of unit-linked products.

Looking Ahead

The growth outlook for life premiums in Emerging Asia remains favorable. In China, the government targets an increase in (total) insurance penetration to five percent by 2020, up from 3.3 percent in 2014. In India, the passage of the Insurance Laws (Amendment) Bill is expected to stimulate the market and also boost consumer confidence in insurers. On the other hand, continued loose monetary policy in the region will put pressure on the competitiveness of life saving products relative to wealth management products offered by banks. And in China, the insurance regulator recently allowed insurers to raise the interest rate ceiling on universal life (UL) products to 3.5 percent from 2.5 percent. This could reignite concerns about negative spreads if insurers start offering more products close to the new ceiling.

Recent interest rate cuts in several countries, including China, India, Thailand and Indonesia, will put further pressure on insurers' profits. This could, however, be partly offset by better investment returns from equity investments, especially in China where stocks have performed well in recent months.

Source: SwissRe Economic Research & Consulting

Emerging Markets
LATIN AMERICA & THE CARIBBEAN

Latest Data

Life insurance premiums in Latin America and the Caribbean grew by 3.3 percent in 2014, down from 4.2 percent growth in 2013 and well below the post-financial crisis average growth rate of around eight percent. With the exception of Brazil and Peru, all other large markets in the region recorded significantly weaker premium growth. Colombia experienced the steepest decline (–18 percent) due mostly to a large pension transfer in 2013 between two state-owned entities. Lower pension and annuity premiums were the main drags on headline growth in Colombia, Mexico, Chile and Argentina. This contrasts with Brazil and Peru, where savings and retirement products have supported growth. In Brazil, which accounts for 60 percent of life premiums in the region, a strong rebound in the popular life-savings product Vida Gerador de Benef.cios Livres (VGBL) was the main reason behind a recovery in premium growth to 5.4 percent in 2014 from 1.3 percent in 2013.

Looking Ahead

The premium growth slowdown in the region is expected to carry over into 2015 and the next couple of years. The rebound from a low base that propelled strong life premium growth in Brazil—and the region as a whole—is likely to fade by the middle of 2015. Weaker consumer demand and rising unemployment will weigh on group life business in Brazil. The outlook is brighter for Mexico and Chile, the second- and third-largest life markets in the region respectively, given stronger macroeconomic fundamentals. However, premium growth will remain below recent trend levels in the short to medium term. Price competition, weaker consumer demand and labor markets, and heightened financial volatility will affect the industry in the region.

Source: SwissRe Economic Research & Consulting

buying closed blocks of business; in the U.K., Resolution and Phoenix are leading the way.

- **Emerging markets.** Historically, Europe and North America were the primary M&A target regions for buyers even as a handful of multinational players made significant headway in various emerging markets. Today, the emerging markets are experiencing lots of M&A play. Since the financial crisis, some global life players have exited the Asia Pacific region and Latin America for strategic and/or balance sheet reasons with others—among them, AIA, Manulife, Sun Life, MetLife and Prudential—have moved in to buy the businesses being sold. According to SwissRe, Indonesia, Thailand, Malaysia and Vietnam have become especially attractive to foreign life insurers. Japanese life insurers have become significant buyers in the Asia Pacific region. Brazil and Chile have experienced significant life industry consolidation within their borders, while foreign buyers are looking to capitalize on Latin America's growing middle class and the rise of private retirement solutions.

Although M&A activity is increasing, several factors are holding a huge rush to deal making at bay. These include regulatory uncertainties, the not-fully-recovered economy, and inflated company valuations. According to SwissRe, the global capital and risk standards currently under development may dissuade life-annuity companies from making acquisitions to ensure they are not labeled as systemically important. Despite these headwinds, emerging market access will continue to propel much M&A activity, as evidenced by the face that more than 60 percent of insurance executives recently surveyed by Accenture/Economist Intelligence Unit said their investment focus will be on assets in overseas markets going forward.

Industry Performance

So, how well is the global life-annuity industry navigating both the positives and negatives of today's business climate? It's gaining momentum, according to the most recent performance data, which SwissRe Economic Research & Consulting publishes every June.

According to this year's report, *Back to Life*, there was a return to positive growth in the life sector in 2014, with premiums up 4.3 percent to US$ 2,655 billion after a 1.8 percent decline in 2013.

In the advanced markets, total life insurance premiums grew by 3.8 percent in 2014, outpacing GDP growth and increasing insurance penetration. This held true for 20 of the 29 markets for which data are available.

In the emerging markets, total life premiums grew by 6.9 percent (well above economic growth of 4.1 percent) in 2014. This was the case in 30 of the 48 markets for which data are available. The key markets where life premium growth lagged economic expansion were Colombia, Turkey and Poland, with a sharp premium decline in all three. There were premium declines in five other emerging countries also.

"Very strong growth in Oceania and solid results in Western Europe and Japan more than offset yet another year of contraction in North America, with falling sales of term and universal life products in the U.S.," according to SwissRe. "In emerging markets, life premium growth improved to 6.9 percent from 3.6 percent in 2013, driven mainly by China. In other emerging regions, premium growth generally slowed or even continued to decline, as in Central and Eastern Europe (CEE). Since the financial crisis, life premiums in the advanced markets have stagnated. In the emerging markets, average annual premium growth has been slower than in the pre-crisis years.

"Profitability in the life insurance sector improved slightly in 2014, driven by stronger stock markets, higher premium growth and cost containment efforts. The sector continued to suffer from low interest rates and overall profitability was below pre-crisis levels. The industry remains well capitalized. In the environment of ultra-low interest rates, unrealized gains on bonds are providing support.

"Life premium growth is expected to remain fairly solid in the advanced economies in 2015 and to increase in the emerging markets, particularly in CEE and China. The U.S. life market is likely to improve alongside the strengthening economy and jobs market. Growth in Western Europe is expected to slow from the strong result in 2014."

Emerging Markets
CENTRAL & EASTERN EUROPE

Latest Data

In Central and Eastern Europe (CEE), life insurance premiums declined by 2.1 percent in 2014 (in 2013, they declined 3.3 percent). However, the overall negative result masks improvements in many countries. In Poland, premiums declined by 12 percent, an improvement on the 17 percent decline in 2013. However, tax changes related to interest earned on savings products, as well as poor investment performance due to capital market weakness, continued to affect sales. In some of the life markets of CEE European Union (EU)-member countries (Hungary, Slovakia and the Baltic States), premiums continued to grow, while in Slovenia, the Czech Republic and Romania, contraction slowed or stabilized. In Russia, life insurance showed some resilience to last year's economic challenges, up 19 percent in real terms, although this was below the average of the previous two years. The premium growth in Russia was driven by sales of credit-related products. Premium growth in Belarus slowed, while in the Ukraine life insurance sales declined by 21 percent in 2014, reflecting the surging inflation that has resulted out of the Russia/Ukraine conflict.

Looking Ahead

In the CEE EU member countries, particularly Poland, life insurance premium growth will benefit from strengthening economies, falling unemployment and rising disposable incomes. Improving equity markets should raise the attractiveness of life insurance products across the region. Premiums in Russia are expected to decline steeply in 2015. With consumer confidence in freefall because of rouble weakness due to the crisis in the Ukraine, surging inflation and interest rates, the consumer credit boom is due to reverse. This will affect sales of life products in Russia.

Source: SwissRe Economic Research & Consulting

Emerging Markets
MIDDLE EAST, CENTRAL ASIA & TURKEY

Latest Data

Life insurance premium growth in the Middle East, Central Asia and Turkey slowed to one percent in 2014 from 12 percent in 2013. In Turkey, which constitutes close to a quarter of the region's life sector, premiums declined by 12 percent while in the UAE, premiums grew by an estimated 12 percent, driven by demand from the expatriate population and a growing middle class. In Saudi Arabia, life premiums grew by 4.2 percent in 2014 after four consecutive years of decline. The previous years' decline was due to a shift in the investment patterns of the general population from savings products like insurance to the greater returns yielded in the equity markets. Elsewhere, life premium growth in Bahrain moderated after a significant slowdown in 2013, due to a fall in family takaful contributions.

Looking Ahead

Overall, the outlook for life insurance in the region is positive. Low penetration rates and increasing awareness will help drive demand. A high proportion of the working age population will push the demand for savings, protection and retirement products. At the same time, growing wealth and personal income will lead to increased demand for wealth protection and accumulation products. Further, increased acceptance and penetration of sharia-compliant products like family takaful will support growth of the life insurance sector. So too will the use of different distribution channels such as bancassurance/bancatakaful.

Source: SwissRe Economic Research & Consulting

Looking Ahead

So, what does the next five years hold in store for life-annuity companies around the world? "Insurance is an industry at a pivotal juncture as it grapples with the impact of new technology, new distribution models, changing customer behavior and more exacting local, regional and global regulations," according to the 2015 PwC report *Insurance 2020 & Beyond: Necessity is the Mother of Invention.*

In 2010, PwC, a leading global consultancy, began carrying out scenario analyses of the trends reshaping insurance in order to determine what the industry would look like by 2020. In the process, it interviewed more than a thousand executives worldwide. PwC published its initial thoughts in *Insurance 2020: Turning Change into Opportunity*; the 2015 report marks the halfway point to 2020.

Insurance 2020's central message is that companies need to address the sweeping social, technological, environmental, economic and political (STEEP) developments that are around the bend. According to the 2015 report, these trends include:

- **Customer evolution.** The insurance marketplace is becoming increasingly fragmented, "with an aging population at one end and a less loyal and often hard to engage millennial generation at the other. The family structures and ethnic make-up within many markets are also become more varied and complex." These changing demographics have significant implications for product design, marketing and sales and represent both opportunities and risks for life-annuity companies. Data analytics, social media dialogue, and multi-channel selling can help.
- **Digitization.** Most insurers have invested in digital distribution and PwC points to the proliferation of new sources of information and analytical techniques, which are beginning to reshape customer targeting, risk underwriting and financial advice.
- **Information advantage.** According to PwC, many insurers are still finding it difficult to turn customer data into actionable insights.
- **Economy.** Slow economic growth and a continued low interest rate environment remain challenges. "Interest rates will eventually begin to rise, which will cause some level of short-term disruption across the insurance sector, but over time higher interest rates will lead to higher levels of investment income."
- **Disruption and innovation.** According to PwC, insurance executives expect to have their businesses disrupted by changes in industry regulation (88 percent), changes in customer behaviors (71 percent), changes in distribution channels (69 percent), and an increase in the number of significant direct and indirect competitors, both traditional and new (64 percent). In response, many insurers are developing new business models in areas ranging from tie-ups between reinsurance and investment management companies to a new generation of health, wealth and retirement solutions, according to the report. "The pace of change can only accelerate in the coming years as new innovations become mainstream in areas ranging from wearables, the Internet of Things and automated driver assistance systems to partnerships with technology providers and crowdsourced models of risk evaluation and transfer."

As you can see, life-annuity companies around the world face a mix of challenges and opportunities. To drive growth, their executives are expanding into new markets and lines of business (and jettisoning those that aren't working any more). According to EY's *2014 Global Insurance CFO Survey*, this is the top executive driver today. These executives also intend to drive business by finding ways to improve profit margins, by turning regulatory change into an advantage, by facing competition from globalization and new market entrants head on, by strengthening risk mitigation strategies, by simplifying operations, and more. *Resource* will keep you posted as they make their way. ◆

Emerging Markets
AFRICA

Latest Data

Life insurance premium growth in Africa slowed to 1.6 percent in 2014 from six percent in 2013. In South Africa—the continent's largest market with 87 percent of the region's premiums—growth slowed to an estimated 0.9 percent from 6.2 percent in 2013 due to a reduction in recurring premiums and lower single premiums flow. This, in turn, was caused by lower economic activity and higher inflation, the latter impacting household income. In the rest of Africa, life premiums grew by more than 10 percent last year, based on estimates and preliminary data for a few countries. Premiums in Morocco, the second largest market, rebounded robustly (+11 percent), driven by a strong recovery in group and individual business, and a surge in unit-linked business from a low level in 2013. The life sector in Egypt continued its solid recovery with 6.5 percent premium growth in 2014, on the heels of 6.6 percent growth in 2013. There was continued positive growth momentum in Sub-Saharan Africa (SSA) too. In Kenya, life premiums were up 18 percent after a 12 percent gain in 2013, and growth was strong in Zimbabwe. In western Africa, the life markets in Ghana and Nigeria are estimated to have grown solidly last year. For other SSA markets, the latest data available are for 2013 only. The numbers suggest that premiums grew by a modest 4.3 percent in SSA (excluding South Africa) in 2013.

Looking Ahead

In South Africa, a gradually improving economy should support growth in the life sector this year. Elsewhere in Africa, premium growth is likely to slow in the oil exporting countries in the near term, as lower economic growth and weaker currencies reduce disposable income. However, in the mid- to long term, very low insurance penetration, strengthening economies, increasing disposable incomes and favorable demographics will boost demand. Even in South Africa, where insurance penetration is high, there is still a large coverage gap for certain population segments and this should boost premium growth in the future.

Source: SwissRe Economic Research & Consulting