



# What should insurers do today to prepare for tomorrow?

Europe insurance outlook 2019



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# Foreword

We are excited to share the latest edition of the EY insurance outlook series, covering the major trends, disruptions and innovations that are reshaping our industry. It's an opportune time to take stock, as insurers are investing more than ever to reshape their business models to take advantage of subtly different growth opportunities around the world.

For this year's outlooks, we brought together EY industry and functional professionals, as well as the strategists and technologists, in highly interactive "think tank" sessions. These groups identified and rank-prioritized the most powerful and dynamic trends and issues that they see in their work across the industry every day. The opportunities to innovate and disrupt are driving both customer-facing transformation and back-office optimization.

The EY team is clearly energized by what's possible for insurance - better ways of working, a clearer sense of purpose, more effective use of emerging technologies and ecosystems, as well as our industry's unique ability to promote financial wellness, provide protection and enable insurance customers to better manage risks. We would be delighted to hear your thoughts on the following report and this intriguing and challenging moment in the insurance market.



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# Europe insurance outlook 2019

Persistent slow economic growth, especially when compared to the US and emerging markets, constrained growth in the European insurance market. After a slightly more positive 2017, growth slowed down again in 2018, although at very different paces within individual markets across the continent.

## Macro-effects and growth outlook

The three largest insurance markets in Europe - UK, Germany and France - saw marginal growth in gross written premiums (GWP) across life and non-life segments in local currency terms during the last five years. However, GWP have declined when measured in US\$ terms owing to the adverse foreign exchange translation effects.

New worries about Italy's budget plan and political direction have added to ongoing uncertainty around Brexit. These factors, when coupled with adverse demographic changes and insurance-specific factors (such as continued price competition), have curtailed growth.

Profitability remains under pressure, too, due to ongoing low interest rates and increasing margin pressures.

Slowing of economic growth and marginal increases in consumer spending are expected in the future. Among the major variables to watch:

- ▶ The retreat of monetary easing
- ▶ The outcome of the Brexit negotiations
- ▶ Further trends to populism in 2019 elections

In this environment, insurance growth is expected to remain weak. Thus, insurers must:

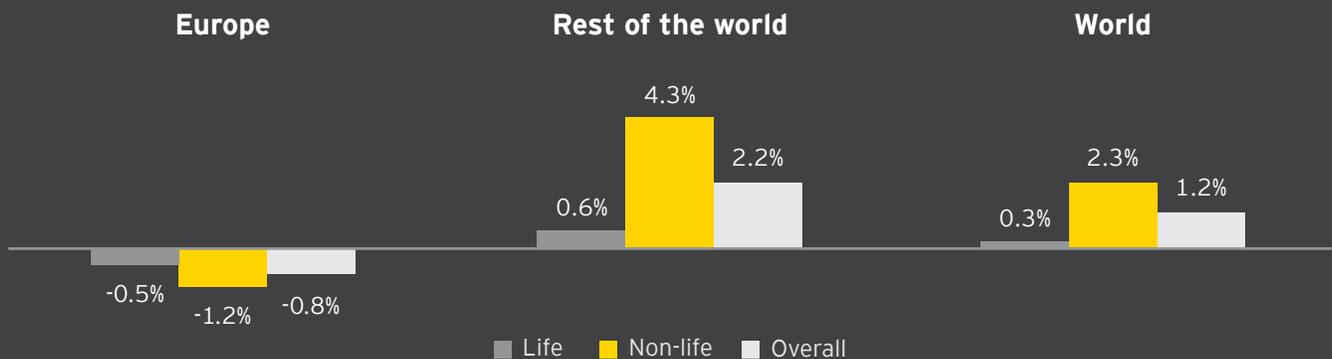
- ▶ Reach a larger client base through digital channels
- ▶ Focus on specific promising niches (such as cyber and health)
- ▶ Deliver on business transformation initiatives

## Digital and InsurTechs: Change and opportunity

Though European investments in InsurTechs have trailed those in North America, they doubled from 2016 to 2017. Consequently, the priorities regarding innovation will continue to evolve, particularly with telematics and Internet of Things (IoT). Some European countries excel in these areas. For example, Italy is particularly advanced in telematics. Blockchain-related initiatives - such as EY Insurwave, a blockchain-enabled platform for the global shipping industry - are also expected to expand. European insurers can - and should - look to other regions for innovations that can be imported and adapted to meet specific needs in unique European markets.

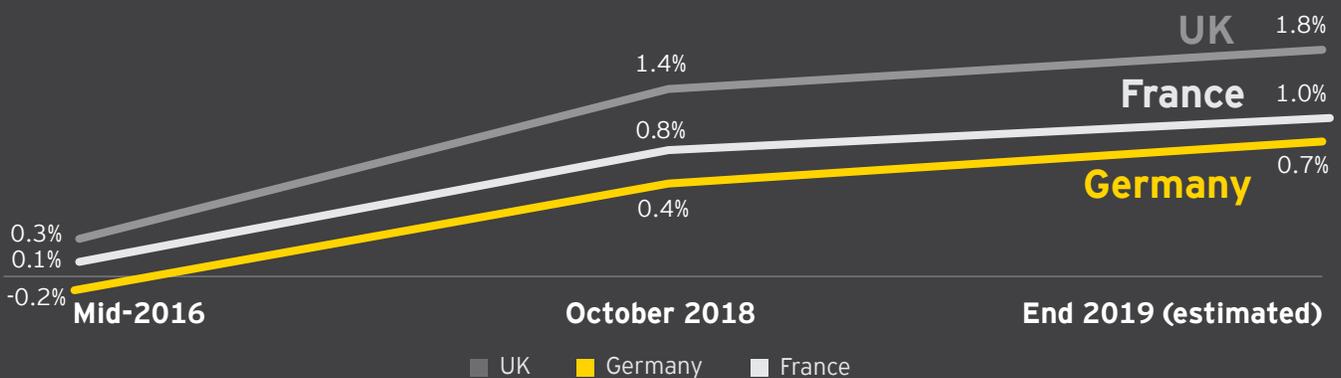
## European insurance market: The big picture

Insurance growth in Europe vs. rest of the world, CAGR (gross written premium in US\$)



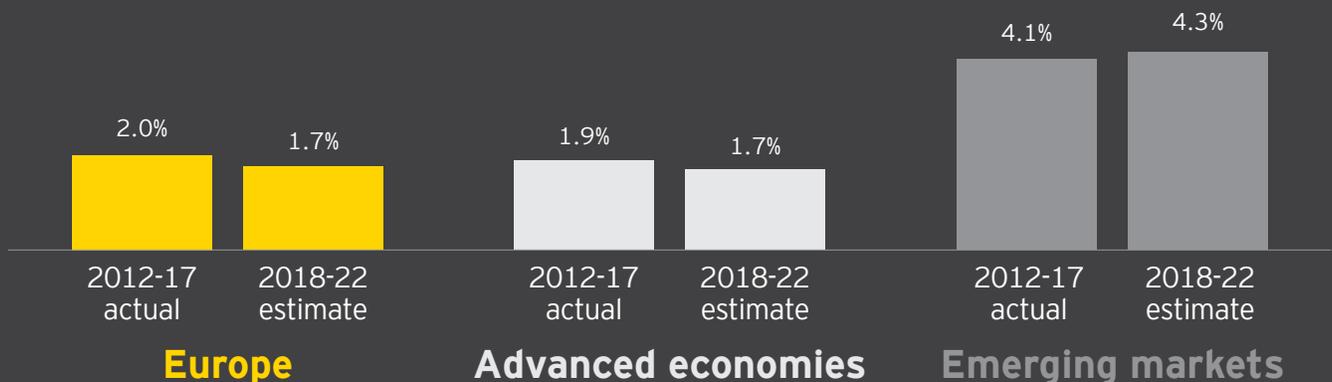
Source: Swiss Re

### 10-year bond yields in top European markets



Source: Oxford Economics

### GDP average annual growth, Europe vs. rest of the world, 2012-2017



Source: Oxford Economics

# The state of the European life insurance market

## Overview and key trends

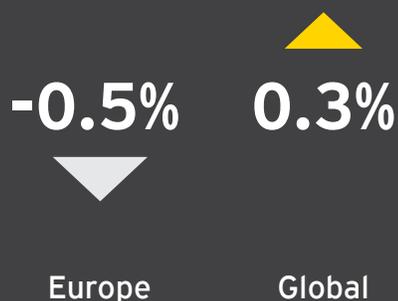
Growth has been weak during the last five years, due mainly to the usual suspects of low interest rates and complex products. Margins have improved, however. Over the longer term, opportunities may arise from the retreating role of the state and the increasing need for individuals to provide for their own retirement savings and income, whether through life or pensions.

Given the state of the market in Europe, life insurers should focus on:

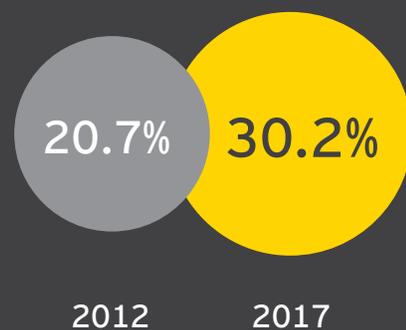
1. **Expanding their value propositions to cater to emerging needs**
2. **Exploring partnerships to foster innovation**
3. **Incorporating regulatory compliance efforts into strategic change initiatives**
4. **Transforming IT platforms to support digital innovation**

## Slow growth, weak performance:

Annual gross written premiums, 2012-2017



Annual premium equivalent margin, top 50 European insurers



## Expanding value propositions: Emerging needs and financial wellness

### EY POV

Changing customer needs require life insurers to change their value propositions.

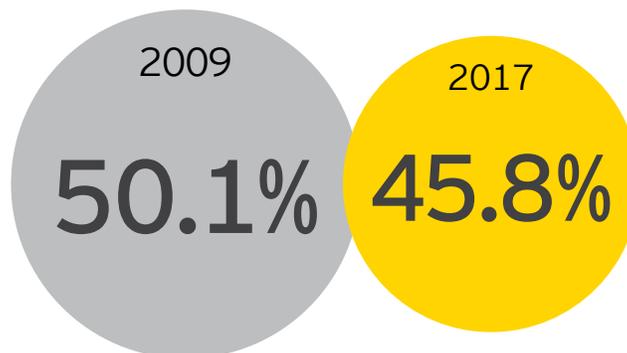
Across Europe, as in other markets, customer behaviors are changing and expectations are rising. At the same time, European governments are retreating from providing pensions, health insurance and other services. *See figure 1* Additionally, the impact of Solvency II and related regulations have made it difficult to write long-term business with guarantees as return on capital is generally below investor requirements.

European insurers are responding with a continued shift to unit-linked products. The big opportunity is to expand their offerings in line with shifting demographics and aging populations (e.g., more products for private health insurance and long-term care). To be competitive, insurers must be willing to deliver topline growth with new products that are initially less profitable.

Delivering financial education and proper advice is also critical. Insurers should explore the development of financial wellness solutions, as moving to outcome-based value propositions will be a major differentiator.

To seize the opportunities presented by expanded product portfolios, insurers must develop new propositions that complement existing ones and can be deployed in more cost-effective ways. The focus should be on integrated omni-channel customer experiences that provide consumers with the same frictionless interaction that they have come to expect from companies in other sectors.

Figure 1: Ratio of government spending to GDP



## Innovation: Partnerships are key

### EY POV

Integrated financial needs management is the key for insurers to remain relevant and they need digital platforms to offer such services.

European insurers have been slow to embrace technology-enabled transformation. They now have to change their approach and consider partnerships as a means to catch up. They will have to work with other parties (InsurTechs) around distribution and innovation. As in other regions, incumbent insurers in Europe will provide capital and risk management elements (rather than distribution elements).

At the same time, new digital platforms designed to help consumers manage long-term financial needs are emerging. That is the natural place to sell digital life insurance; thus insurers should seek to integrate themselves in these ecosystems.

Consumers still gravitate toward big insurance brands that have taken years - and in some cases, centuries - to build. These platforms represent a great opportunity for those brands that can seize it.

Such platforms enable insurers to deploy advanced robo-advisory models, which provide them with potential access to the large audience for these offerings. Those insurers that position themselves correctly in this space will enjoy the substantial benefits of robo-advisory models.

# Regulatory compliance: Incorporating with strategic change initiatives

## EY POV

Tick-the-box approaches to regulation usually leave business value on the table.

When it comes to regulations, insurers must seek to balance two sides of the equation: complying with existing requirements and keeping an eye on potential new regulations. After two decades of regulatory changes, insurers have come to accept that tactical responses are ineffective, while more strategic approaches can create value for the business.

Pursuing this balance is increasingly important today, given the wave of pending regulations, including new accounting standards, such as the International Financial Reporting Standard 2017 (IFRS 17), international capital standards and the General Data Protection Regulation (GDPR), which still requires attention though it is already in place. *See figure 2* Given the continued rise in regulatory oversight, it's no wonder that a majority of industry stakeholders expect compliance costs to rise.

# 61%

Respondents answering, "Over the next 12 months, I expect the cost of senior compliance staff to be significantly or slightly more than today (2018)."

Source: Thomson Reuters

To generate business value from their compliance investments, the key is to look beyond silos. For instance, the impact of IFRS 17 will reach far beyond accounting systems. Similarly, GDPR should not be viewed simply as a data systems project. In fact, insurance executives should consider the impact of IFRS 17 and GDPR as they make strategic decisions around business and market mix and assess their future performance outlook.

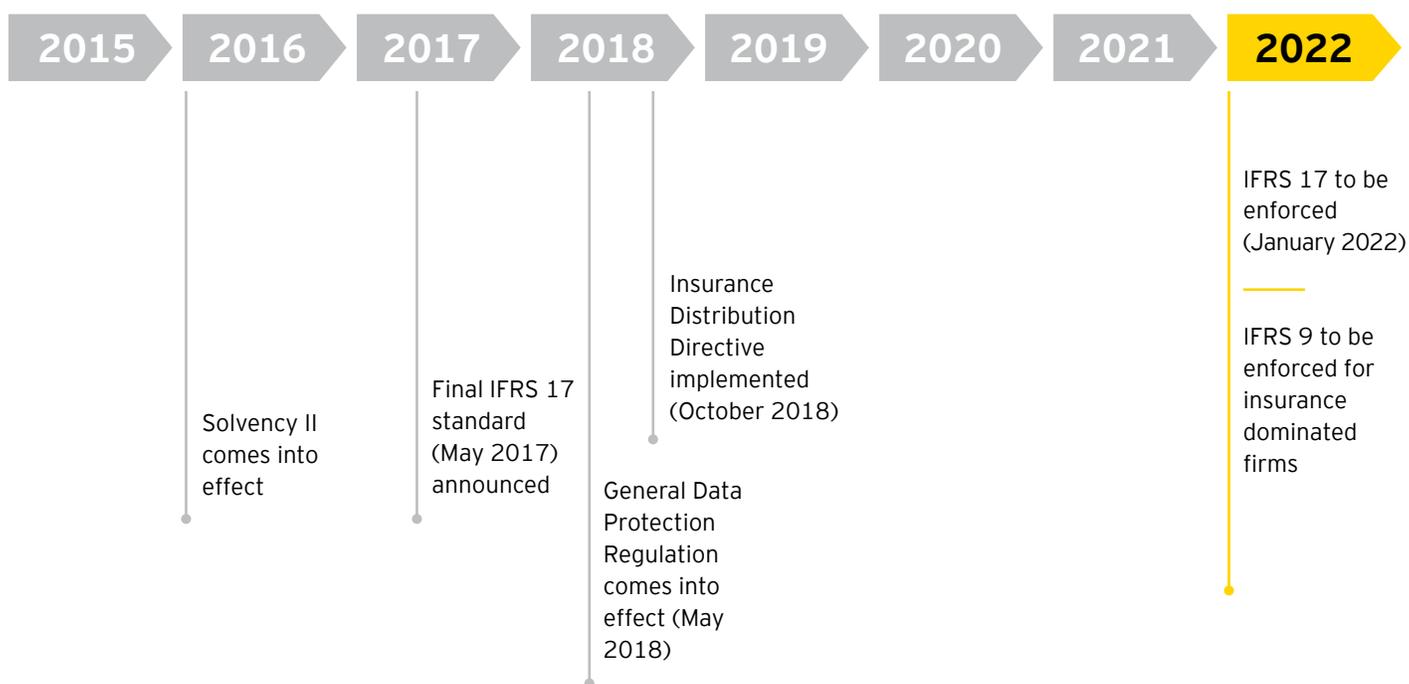
It's well known that the pace of digital change necessitates new regulations. Regulators will be challenged by the pace of the change, as well as their limited budgets. They may not be able to define requirements as quickly as insurers can innovate. There is also risk that regulators will simply ban the use of technologies they don't understand. This would slow industry progress. Regulators too must become more agile and able to adapt to innovation at a faster pace than in the past. Insurers might decide to limit innovation in certain areas where they believe the regulators will legislate later, which would help control compliance costs.

There is a natural tension between innovation and regulation. The burden and risk-averse nature of regulation constrains innovation. Regulators in Europe and elsewhere are trying to adopt technological change; in several markets, including the UK and Italy, they have been adopting regulatory sandboxes. So, they are not stuck in time. Forward-looking insurers should also engage with regulators to explore sandboxes and consult on the evolution of the sector.

Insurers have an opportunity in the near future to optimize their business models in ways that streamline compliance and create business value. New approaches to compliance are already showing the way forward. For example, some European insurers are investing more than the minimum for IFRS 17 and building systems that create broader strategic value beyond compliance.

They recognize that minimalist approaches to compliance do not necessarily equate to minimum investments. In all cases, compliance efforts are multi-dimensional, involving stronger data and governance models, new or updated systems and enhanced processes.

**Figure 2: Timeline of major European regulatory changes**



Source: EY analysis

## IT transformation: Platform development to support digital innovation

### EY POV

European life insurers must accelerate the evolution to digital, but evolve in ways that appeal to customers.

Many large European insurers maintain largely traditional operations and are just beginning to move toward digital. They are very eager to move legacy products and customer interactions to digital platforms and channels. This interest explains the dramatic rise in InsurTech investments. *See figure 3* However, old legacy products cannot be smoothly transferred to new platforms, as some insurers have experienced. Going forward, new solutions are likely to emerge to facilitate these transitions and help insurers reduce their costs.

**Figure 3: Growth in European InsurTech investments, 2016-2017**



**267%**

There is consensus about the need to move to digital, but some questions around goals remain. Specifically, what will insurers and their customers gain from the shift to digital? Will customers really want to check the value of their insurance policies multiple times? Such questions are more easily addressed by general insurers than life insurers.

Thus, some insurers are taking more time to assess the effectiveness of digital. They are weighing the necessary large upfront investments against the benefits, including significant reductions in future acquisition and servicing costs.

To move forward successfully, life insurers will need to:

- ▶ Consider the right mix of new systems and technologies to achieve strategic objectives
- ▶ Create value by feeding collected data back to the consumer, becoming more responsive in products and pricing and providing greater visibility to consumers around their goals (e.g., healthier living, retirement savings)
- ▶ Leverage artificial intelligence (AI) and machine learning in decision making, reaching out to customers and reinventing products and business models

## Imperative actions: What life insurers should do next

In this time of change, life insurers must stay strategically focused and take practical actions, including:

### 1.

Determine the best approach to the business mix and value proposition by analyzing each part of the value chain holistically and defining what is the core offering, where to invest and what to outsource.

### 2.

If entering new fields of play considerably different from traditional operations, conduct a cost-benefit analysis to decide if “greenfield” approaches or gradual upgrades make more sense.

### 3.

Examine regulatory changes focused on core operations, apply the standards to major product lines and look beyond compliance for opportunities to create business value.

### 4.

Evaluate existing IT systems and identify staged conversion plans to replace them with agile, cloud-based platforms.

# The state of the European non-life insurance market

## Overview and key trends

Like the life insurance sector in Europe, the non-life insurance segment also experienced weak growth during the last five years. As expected, economic conditions had a strong effect on the performance of non-life insurers, with some upside during 2016 and 2017 due mainly to relatively faster GDP growth.

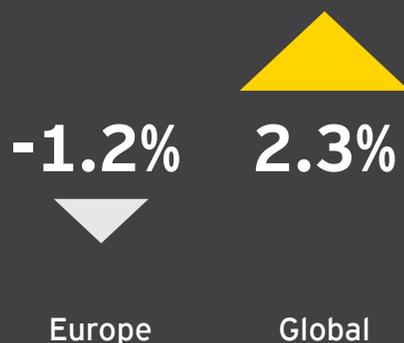
Going forward, non-life insurers must cater to evolving customer needs and apply new technologies - both in customer-facing channels and in the back office - if they are to unlock growth and improve profitability.

Four key priorities for non-life insurers:

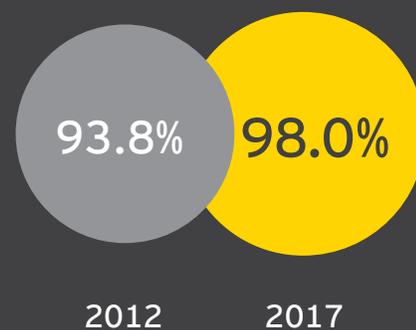
1. **Adapt to rising customer expectations**
2. **Identify the right roles in emerging ecosystems**
3. **Drive cost efficiencies to deliver stronger return on equity (ROE)**
4. **Infuse innovation, including big data, analytics and artificial intelligence (AI), into operations**

## Slow growth, weak performance:

Annual growth in GWP, non-life, 2012-2017



Combined ratios, reported average of top 20 European P&C insurers



## Rising customer expectations: The necessity to adapt

### EY POV

Digital should not be a goal in its own right. Satisfying customers with the right digital mix should be.

Expectations across the customer lifecycle are rising rapidly and insurers will have to transform their enterprise to be able to meet them. *See figure 4* Transformation opportunities are being driven by emerging smart technologies, from AI, robotics and blockchain, to IoT, telematics and wearables. Not only are these technologies critical to engaging and satisfying customers, but they will also transform the future of work and redefine the talent needs of insurance companies.

One big challenge for P&C insurers: while they desperately want relationships with their customers, most customers don't want a regular relationship with their insurers. Relationships are different in insurance than in retail. In this context, the focus has to be on building capabilities to improve front-end interactions and bring relationships to the next level for personal and small and medium enterprise commercial lines.

In commercial insurance, there is a big gap between consumer expectations and current service delivery. While the front-end can certainly be improved for commercial customers, the greater improvement opportunities are in back-office operations, where it's relatively harder to innovate.

For both personal and commercial lines, initiatives to deliver against elevated expectations must be focused on meeting the real needs and expectations of the customers (such as rapid responses to service inquiries and quote requests), rather than what insurers would like to see.

Figure 4: Customer interactions and experiences with insurance

# 91%

UK insurance customers who say good digital customer service makes them more loyal, 2017

# 68%

Share of routine questions asked through web, email, Twitter and Facebook, which UK's leading insurers failed to accurately answer, 2017 (up from 47% in 2016)

## Ecosystems: Finding the right role

### EY POV

From M&A and JVs to alliances and “newcos,” insurers must pick the best option for developing ecosystems and engaging with InsurTechs.

In Europe, as in the rest of the world, P&C insurers grapple with the challenge of what role to play in emerging ecosystems and are confused about how to work with InsurTechs. They receive a lot of requests for collaboration, but don't always understand InsurTechs' business models. This gap is understandable to some extent; insurers are conservative companies with long histories and can't be converted to thinking and acting like startups overnight. Regulation also acts as a brake on innovation.

However, the concept of an ecosystem is not new. A case can be made that the industry is already such a system, involving brokers, customers, agents and governments. The question for insurers is how to differentiate within existing and emerging systems.

Innovation is one proven strategy for differentiating. Another is the critical decision about what capabilities insurers should own and manage themselves and what they should outsource to external partners or service providers. In such collaborations, insurers must focus on maintaining competitive pricing through the right partnerships.

Compared to attitudes in the US, the general feeling in Europe is that insurance companies can play pivotal roles in emerging ecosystems, such as auto and health. Insurers will need to be flexible in thinking how to orchestrate their own ecosystems (e.g., in commercial insurance) while also contributing to new ecosystems (e.g., those that emerge around the sharing economy).

To make the most of these opportunities, insurers must determine their best option - “newco” development, mergers and acquisitions, joint ventures, alliances - to drive growth. They will also have to build multiple scenarios to identify inflection points for new ecosystems in order not to miss out on opportunities. For example, analysts can track sharing economy trends to identify when and where inflection points will be reached.

### Product for new ecosystems:

Drover, a UK-based ride sharing and mid-term car rental company, partnered with Munich Re to offer a unique insurance product for gig-economy drivers.

*Source: Fleet Europe*

## Back-office infrastructure: How to deliver ROE

### EY POV

Cost efficiency is a prerequisite for profitability and future investments.

As seen in other regions, cost efficiency remains a key priority for the European insurance sector. Insurers need to reduce costs to maintain their ability to invest and be profitable. While there is a huge focus in P&C on transforming claims and policy administration platforms, the return on investment is not clear as expense ratios have not dramatically improved. In fact, they've risen. *See figure 5*

The challenge for P&C insurers is clear: how to deliver ROE and maintain profitability when faced by strong headwinds. The specific issues include:

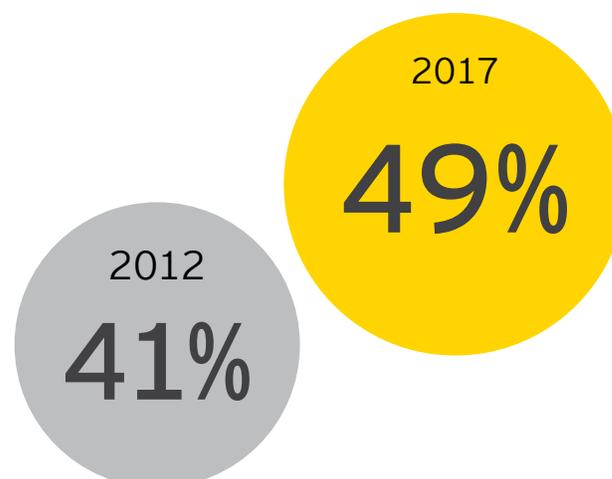
- ▶ Low growth and a weak global GDP
- ▶ Low interest rate environment
- ▶ Little to no incoming investment
- ▶ A very mobile market for source of capital

In such an environment, where cost efficiency is at a premium, back-office infrastructure becomes critical. A more strategic approach is required for most insurers. While change is expensive and difficult (even painful), it is necessary to achieve the cost savings that have proven elusive over the last few years.

To achieve these improved efficiencies, European insurers should exercise extreme caution while adopting new platforms and be discerningly clear about the target outcomes and the net impact on customers and capacity. It's also important to invest in flexible models that can be upgraded easily to position the organization to extract maximum benefit.

While new platforms certainly improve efficiency, they can also help companies grow by expanding the customer base. European P&C insurers are already leading in areas such as telematics. To add value to the business and the customer experience, they need to deploy the right mix of technologies, focusing more on AI and blockchain.

**Figure 5: Underwriting expense ratio, top 20 European P&C insurers, 2012-2017**



Source: S&P

## Innovation and the talent agenda: Big data, analytics and AI

### EY POV

To infuse innovation, insurers need the right talent. To get the right talent, they must demonstrate their commitment to innovation.

New platforms and advanced technologies are critical components of innovation, but they are not the only ones. Cultural and human factors are just as important. Tomorrow's top insurers will be fully committed to innovation and seek to infuse data-driven and analytical thinking into everything they do – from customer acquisition to pricing and underwriting to customer service and claims.

Big data and analytics increasingly drive the value in the retail world. Despite a cautious approach from the EU on data privacy (i.e., GDPR), customers are increasingly willing to share more data. Insurers need to focus on creating new streams of data through relevant partners and create data lakes that they can leverage for improved business and customer outcomes.

While the application of this data will be fundamentally different in each sub-segment of insurance, the value will be significant in driving more effective risk acquisition and more accurate risk pricing.

While other industries are already making significant steps in this direction, insurers are struggling. Talent is one of the key reasons. Insurers need new types of skills, particularly around data manipulation, analytics and other advanced technologies. Workers with these skills are in high demand across many sectors and are not likely to think of insurers as employers of choice.

To attract the right talent in this competitive environment, insurers must communicate a fresh image of themselves as fully committed to innovation and digitally friendly environments. In the absence of such a bold repositioning, the aspiration to infuse innovation is likely to remain just that.

## Imperative actions: What P&C insurers should do next

The P&C sector is going through a massive amount of change, but thankfully, the potential upside is huge. Unfortunately, insurers have struggled to get shareholders fully on board with this narrative, because investors like the industry's historically strong cash flows. However, the outlook is clear and straightforward: markets are growing and winning in them requires investment.

Balancing present needs and future opportunities is also challenging. Thus, insurance leaders need to articulate their growth strategies and narratives in terms of working within the complex environment and not overstretching. The first steps should include:

### 1.

Build a baseline of what is needed across the value chain today and overlay that with at least three different scenarios to understand where your strengths and vulnerabilities lie.

### 2.

Based on such a review of the value chain, assess which parts of the business merit investment and which parts are a better fit for a broader industry ecosystem.

### 3.

Evaluate how to create an innovation culture - whether through incubators or pilot programs - to attract and retain key talent.

### 4.

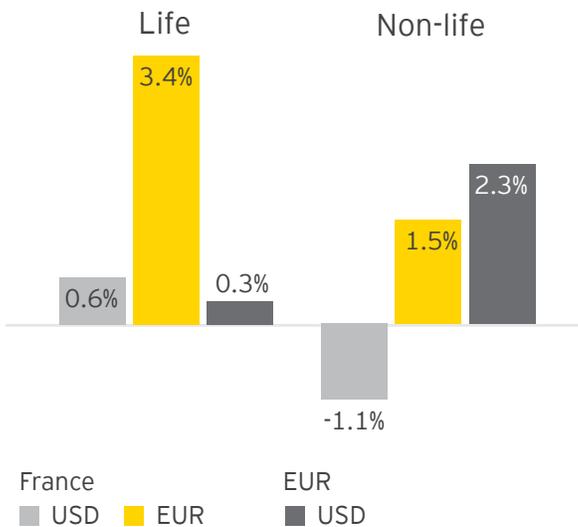
Focus on real customer needs and pain points rather than on what insurers feel is important.



## France insurance outlook: Slow growth and fierce competition

The French insurance sector saw marginal premium growth in 2017, largely due to a recovering economy and political and regulatory uncertainty. According to the French Insurance Federation, insurance premiums rose 1.4% in EUR terms. Sickness and personal injury accident insurance achieved the strongest growth, at 4.8%. Property and casualty (P&C) grew by 2.3%, particularly in personal lines. And life, health and protection insurance rose by a mere 1.1%. *See figure 6*

**Figure 6: Growth in gross premiums, 2012-2017**



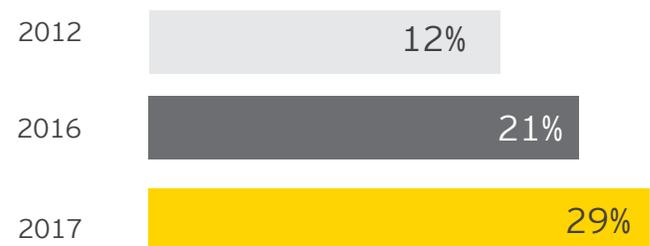
Source: Swiss Re

### Profitability: Adapting to the low interest rate environment

French insurers are seeking to protect profits by adapting their business mix to the low interest rate environment. Since 2012, the industry has shifted toward unit-linked and capital-light products and away from traditional guaranteed-return savings offerings.

Specifically, 2017 saw strong growth of 36.7% in unit-linked products, rising to €38.4bn. That year also saw a fall in EUR-denominated products, down 9.1% to €96.2bn. Share of unit-linked products has thus risen to 29% of premiums in 2017. *See figure 7* Overall, European insurers are taking more investment risks and seeking new asset classes to squeeze more yield out of their portfolios.

**Figure 7: New business by product  
(% of annual premium equivalent)**



Source: French Insurance Federation

### Life: Improved rate spike resilience

Life insurers continue to reduce policyholder returns as a means to offset the impact of low interest rates, but still provide better returns than regulated savings. They have also reduced their credited rates in line with the decline in their investment returns. Thus, the average guaranteed rate in France is among the lowest in Europe, while French insurers' ability to reduce credited rates is among the highest.

Life insurers have also steadily increased their deferred profit participation reserve, used to increase credited rates when investment returns are low. Doing so allows insurers to pay competitive policyholder returns even in the event of a sharp rate increase.

That's especially important because a rate spike is one of the French life insurance industry's biggest risks. In such a scenario, many customers would be incited to cash in their policies and invest in products with better returns. Such action could force insurers to sell fixed income assets to cover surrender costs. Because higher rates would depress insurers' fixed income portfolios' value, forced sales could crystallize losses and erode capital.

### Life: Threats to long-term profitability

Baby-boomers reaching retirement have driven the increase in outflows. While low inflows are partly short-term, they also reflect growing competition from banks and asset managers. Current economic reforms such as France's recent PACTE1 law may further increase competition from asset managers. Life insurers' ability to develop innovative and differentiated products will be key to the industry's long-term profitability and growth.

### Health: Business on the rise

Many insurers seeking to differentiate themselves and find new avenues for growth have opted to develop health and protection offerings. This market is characterized by intense competition between traditional insurers, health mutuals and provident institutions. Health mutuals hold a very high share of the individual health market, while provident associations are a major force in the group market.

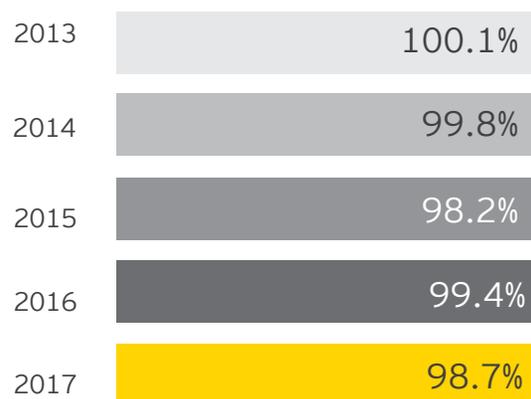
The supplementary health insurance market grew by 2.3% in 2017, amounting to €37.1bn in premiums. Growth came predominantly from group contracts, rising 4.4% to €17.4 bn. Yet premiums grew for both insurance companies (+4.9%) and provident institutions (+3.0%). The protection insurance market also grew by 4.4% to €21.4bn in premiums. Group contracts accounted for 55% of total premiums, according to the French Insurance Federation.

### P&C: Competitive pressure detrimental to combined ratio

Competition is fierce in the P&C segment. Banks that sell insurance products through their branch networks, or bancassureurs, are increasingly putting pressure on the insurance sector. Bancassureurs held a market share of 14% in 2017, up from 13% in 2016 and 10% in 2012. We expect this trend to continue as most French banks have identified P&C insurance as a major source of growth in their strategic plans.

The auto insurance market is the largest P&C segment in France, accounting for 39% of premiums, despite being generally unprofitable. Auto has posted an underwriting loss in each of the last 10 years, with a combined ratio consistently higher than 100%. Competitive pressure will also hold back price growth, further limiting the potential for any improvement in the insurance industry's overall combined ratio. *See figure 8*

**Figure 8: Combined ratio development in France non-life insurance**



Source: Plan d'Action pour la Croissance et la Transformation des Entreprises (Action Plan for Business Growth and Transformation)

## Imperatives for French insurers

The P&C sector is going through a massive amount of change, but thankfully, the potential upside is huge. Unfortunately, insurers have struggled to get shareholders fully on board with this narrative, because investors like the industry's historically strong cash flows. However, the outlook is clear and straightforward: markets are growing and winning in them requires investment.

Balancing present needs and future opportunities is also challenging. Thus, insurance leaders need to articulate their growth strategies and narratives in terms of working within the complex environment and not overstretching. The first steps should include:

**1.**

Explore partnerships to foster innovation and embrace new ecosystems.

**2.**

Enact digital transformation.

**3.**

Adapt to changing customer expectations, and provide differentiated products.

**4.**

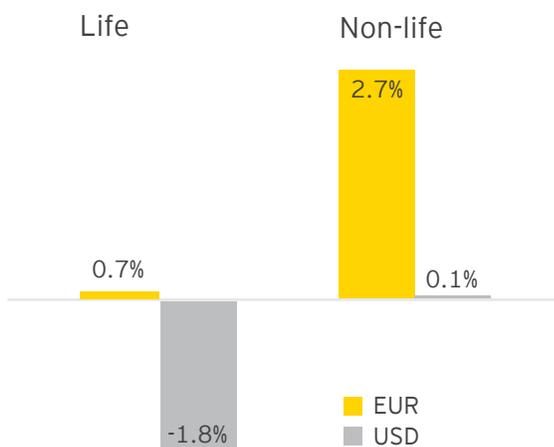
Improve operational efficiency.



## Germany insurance outlook: Adapting to low interest rates and diversifying investments

As the world's sixth-largest insurance market, the German insurance industry is effectively adapting to the challenging global market environment. Benefiting from a relatively stable economic environment, the market saw single digit growth in the non-life space, while life insurance remained flat. *See figure 9* Despite limited growth, the market performed well on profitability parameters and achieved relatively favorable product mix.

**Figure 9: Growth in gross premiums, Germany, 2012-2017**



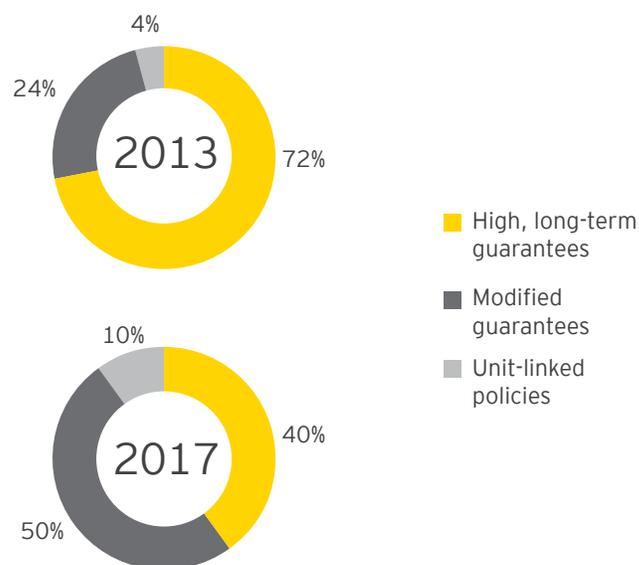
Source: Swiss Re

High penetration makes competition extremely fierce in both the life and non-life segments. German life insurers face shrinking ROI and low interest rates, yet are still obligated to finance long-term guarantee policies. However, recently reduced Zinszusatzreserve (ZZR), or interest rate reserve, requirements will offer more freedom to allocate assets as insurers see fit. In the larger industry, robust balance sheets and strong underwriting disciplines find non-life insurers well positioned to absorb market pressure.

### Life: Low interest rates and structural changes

Given traditionally high guaranteed returns and long contract durations, persistently low investment yields are life insurers' largest concern. They are evolving their business mix to keep pace with other markets in the region, shifting toward fewer interest rate-sensitive and more capital-light products. *See figure 10* However, traditional capital-intensive products will continue to dominate the life insurance landscape for the near future.

**Figure 10: New business by product (% of annual premium equivalent)**



Source: German Insurance Association (GDV)

German demand for life insurance remains fairly positive despite wider economic challenges. A stable economy, coupled with a growing retirement-age population with a growing need for retirement income, are strong growth drivers for the future.

### Life: Readjusting the interest rate reserve

Even if interest rates remain low, German life insurers are required to make additional provisions to the ZZR in order to meet previous years' high guarantee commitments. Thus, life insurers have had limited investment freedom. To avoid such a challenge in the future, in October 2018 regulators introduced a new calculation method that will lower ZZR building requirements. The German Insurance Association (GDV) estimates that the reform will significantly lower the industry's cost going forward. Insurers will be able to allocate assets more in line with customers' risk/yield preferences, offsetting the shrinking traditional savings business.

### Life: Offloading portfolios to minimize liabilities

In the current market, some large insurers are selling - and will continue to sell - existing portfolios to cut traditional life insurance business exposure and reduce the liabilities on their balance sheets. For example, Generali Leben recently sold its life insurance business for nearly €1b in the largest runoff deal in German history. AXA also sold 260,000 life contracts through its multi-employer Pensionskasse for €3b. Unlike the US or UK, where such runoffs are standard practice, this approach is still fairly new for the German insurance industry, though it is expected to become more common.

### Digital in non-life: Emerging technologies and transformation

German non-life insurers are optimizing their operations with new technology and contributing to digital transformation both domestically and in the wider global marketplace. Traditionally, the German insurance industry has been known for its caution rather than for pioneering innovation. However, changing customer behavior and emerging technologies are prompting German insurers to invest more heavily in digital capabilities. The main focus areas in the German non-life insurance space include internal process simplification and improving customer satisfaction. Thus, product innovation remains an important differentiator. German insurers are actively partnering with InsurTechs and other technology providers to underwrite offerings and insure clients. For example, Allianz recently partnered with Cisco and Apple to launch an extensive cyber risk management solution.

As auto insurance is the largest commercial line in Germany, insurers are deploying extensive resources in the development of digital capabilities. Telematics-based insurance is one priority. Cyber risk is also a growing concern, with cyber protection insurance increasingly gaining momentum across both the auto and home insurance sectors. ERGO and Deutsche Telekom's joint digital solutions for smart home and auto cyber security are prime examples of this digital shift.

### Sustainability: Optimizing the value chain

German non-life insurers are well positioned to meet current market challenges as well as close the current profitability gap facing most major non-life insurance markets. Modest price increases should also bolster insurers' profitability. Further, the market has observed a strong underwriting discipline over the past decade, and has reported combined ratios below 100% for the last four years. *See figure 11*

**Figure 11: Combined ratio development for non-life insurance, Germany**



Source: GDV



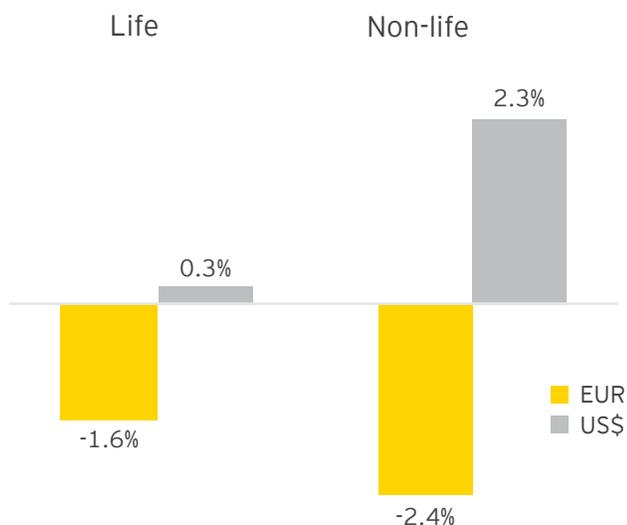
# UK insurance outlook: Transitioning to a new normal

Despite being the fourth-largest in the world, the UK insurance market has seen growth taper off in recent years due to a slew of regulatory changes. *See figure 12*

Though overall premiums have increased as measured by GBP terms in the last five years, they have declined as measured by USD, due to depreciation of the GBP's value. Low interest rates and weak investor returns continue to challenge the life sector, while intense competition and lower economic activity due to

Brexit have affected non-life insurers. Despite existing regulatory challenges and geopolitical uncertainty, an uptick in interest rates and historically low unemployment are likely to support steady market demand.

**Figure 12: Growth in insurance market gross premiums, 2012-2017**



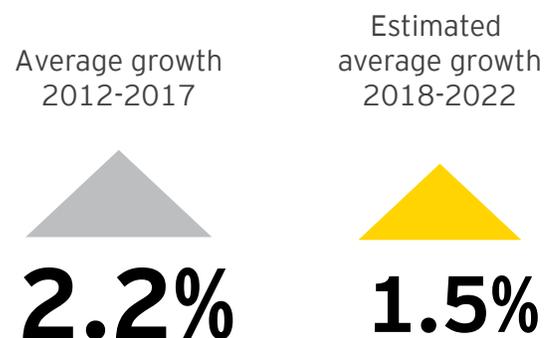
Source: Swiss Re

## Brexit: Preparing for the future

Ongoing Brexit negotiations are causing widespread economic uncertainty. As a result, growth is likely to continue to taper.

*See figure 13*

**Figure 13: UK GDP growth rate**



Source: IMF

With outbound insurance set to lose EU passport rights, UK-based insurers must ensure they have a full subsidiary within EU jurisdiction to continue doing business. So far, Dublin and Luxembourg have emerged as the preferred destinations. By taking a proactive approach, insurers will be able to effectively manage operational risks and use the transition phase as an opportunity to optimize their operating models. However, the impact may be greater for smaller players.

### **Life: Persistent regulatory headwinds affecting business**

In the wake of major regulatory changes such as Retail Distribution Review (RDR), Pension Freedom and Solvency II, UK life insurers are bracing for further customer treatment regulations. The Financial Conduct Authority (FCA) is examining the individual pension and investment platform markets, in addition to its ongoing review of non-advised annuity sales practices.

Such action could lead to increased competition and may have a negative impact on margins. For example, in 2017, an FCA review led Standard Life Aberdeen and Prudential plc to set aside £215m and £400m respectively for redress payments.

### **Bulk annuities: Continuing growth**

Bulk annuity deals have become more prevalent in recent years, and the trend looks likely to continue. The market's total value reached £20bn through the first half of 2018, compared to a mere £12bn through the entire 2017 fiscal year. Insurers consistently focus on this segment as employers offload liabilities from defined benefit pension plans and as the individual annuity market continues to decline. Rising interest rates have also narrowed the funding gap in pension schemes, making bulk annuity deals more affordable. Going forward, competition will remain strong for a share in the £2 trillion UK defined benefit liabilities market.

### **Motor: Improving prospects**

With the net combined ratio dropping to 97% in 2017 from 109.4% in 2016, motor insurance - which accounts for one third of non-life premiums - saw its best underwriting performance since 1994. The improvement was driven by rate increases, a fall in injury claims and Ogden rate reserve releases. We expect the combined ratio to remain just below 100% in 2018 but rate reduction to bite in 2019 and bring the ratio above 100%. While rates declined through most of 2018, they are expected to rise again due to rising claims inflation particularly in Own and Third Party Damage. *See callout*

A number of reforms are set to strengthen the motor sector in the medium-term, including revision of the Ogden rate, the Civil Liability Bill and the requirement of medical evidence to support claims.

After a 5% motor market premium reduction from its peak, a return to growth is expected in 2019.

*Source: The AA, ABI, Confused.com, EY analysis*

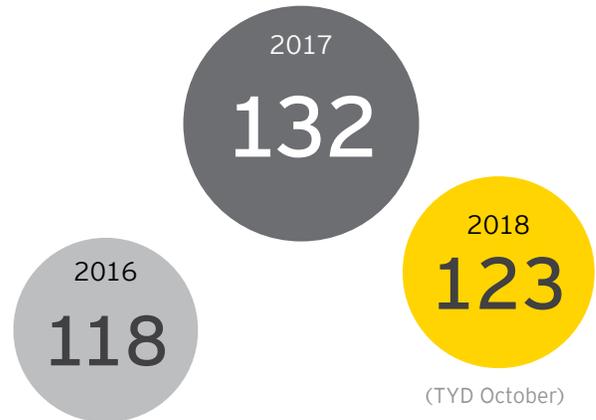
### M&A: Activity to remain high, particularly for brokers

Due to sustained competitive pressures and private equity interest in the sector, M&A activity remained strong in 2018, particularly among brokers. *See figure 14* Continued margin pressure is likely to lead to further consolidation in the insurance and intermediaries market, with large players looking to build scale. Marsh & McLennan's recent announcement of its intent to acquire JLT for US\$5.6bn is one of the largest such deals.

### Future: Leadership in insurance innovation

London has been and remains a leading European and global InsurTech hub. *See figure 15* With the established presence of many large insurers, a vast talent pool and many funding sources, the city is almost certain to remain in that role. In the motor sector, the Automated and Electric Vehicles Act is paving the way for mainstream adoption by extending the compulsory motor insurance clause to driverless vehicles. In the London market, considerable modernizing work is underway around the target operating model (e.g., the use of setting electronic placement of risk targets). Insurers must effectively respond to the rapid, technology-driven changes by offering superior customer value and optimizing operational costs.

Figure 14: Number of M&A deals, UK



Source: S&P Market Intelligence

Figure 15: London as innovation hub

# #1

Number of start-ups globally

# #1

Funding in Europe

Source: Venture Scanner

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