



2014 Property and Casualty Insurance  
Industry Outlook  
Transforming for growth  
Innovation leading the way

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# Foreword

## Dear colleagues:

"It was the best of times, it was the worst of times. . ." So begins Charles Dickens' *A Tale of Two Cities*. In many ways, this describes pretty well the environment that the financial services industry is facing as we head into 2014. The economy is showing some signs of life, balance sheets are stabilizing, and consumer and manufacturers' confidence indices are trending toward the positive. That said, next year will likely be one of ongoing challenges for industry executives to realign business models, adjust to increasing amounts of regulation, and attempt to innovate for growth.

Insurers' growth prospects will be impacted by the strength and staying power of the economic recovery. Strategic planning by carriers will be affected by marketplace and regulatory uncertainty. The way insurers traditionally conduct their business will be challenged by new competition from both within and perhaps outside the traditional insurance industry.

This doesn't mean insurers don't have the ability to control their own destinies. While constantly reassessing their standard operating procedures, systems, and personnel, they should be prepared to make transformational changes. Innovation may ultimately be the key to keep insurers growing regardless of shifting economic and insurance market conditions, as they devise ways to thwart ongoing and emerging competitive threats as well as capitalize on new opportunities.

We are pleased to share with you this outlook for 2014, based on original research combined with the insights and first-hand experience of many of Deloitte's leading insurance practitioners. The content is organized into six major topical platforms, which are designed to explore both industry-wide competitive and market dynamics, as well as examine tactical trends and opportunities within individual firms, providing insights aligned to the following:

- **Competition and markets** — Evaluates existing industry structure, the competitive landscape, and market composition.
- **Clients and products** — Explores emerging trends in retail and institutional customer behaviors, attitudes, and needs.
- **Governance, risk, and compliance** — Reviews industry risk management practices and regulatory mandates, as well as their potential financial and strategic impacts on industry participants.
- **Financial management** — Highlights how finance leaders can better support their business partners and provide needed insights to their firms.
- **Organizational effectiveness** — Analyzes how firms have responded to talent, process, and other operational challenges.
- **Technology dynamics** — Examines the evolving role of technologies in the industry.

We've included a graphic element, which you'll see throughout the report, that provides a signpost as you navigate the outlook. If you pick up more than one of our financial services outlooks, you'll be able to easily compare how the various industry sectors are addressing the six issues by visiting the corresponding section.

We hope you find this report insightful and informative as you consider your company's strategic decisions in the upcoming year. Please share your feedback or questions with us. We would value the opportunity to discuss the report directly with you and your team.



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# Innovation may be the ‘new normal’ for insurers seeking long-term growth

## The race for growth is on

On the surface, the property and casualty insurance business appears to be doing quite well — at least when compared to the past few years. Overall premium volume continues to rise thanks to higher prices and the expansion of insurable exposures in a slowly growing economy. Catastrophe losses have been relatively modest, helping produce an industry-wide underwriting profit of \$2.3 billion and a positive combined ratio of 97.9 for the first half of 2013, a big improvement from the net underwriting loss of \$6.3 billion and a combined ratio of 101.9 a year earlier. And the industry also has plenty of capital on hand, with aggregated policyholders’ surplus at an all-time record high.<sup>1</sup>

Of course, such conditions can change in a hurry. Ongoing political gridlock in Washington could undermine an already unsteady and perhaps weakening economic recovery. Regulatory uncertainties abound, making it difficult for carriers to plan ahead and determine operational priorities. And the industry is always one major catastrophe away from a multi-billion-dollar hit to its bottom line.

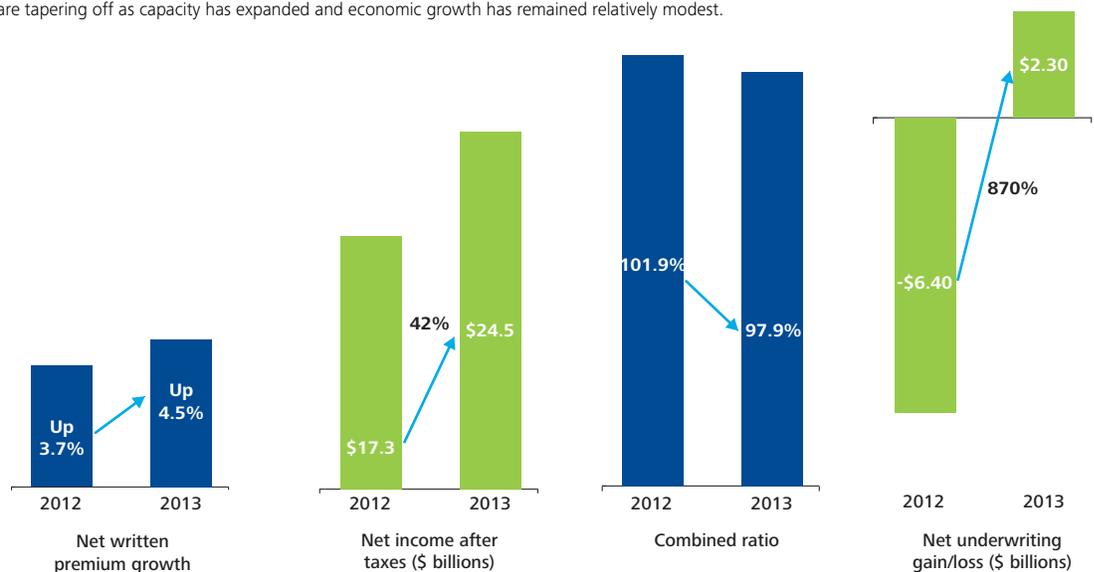
On a more fundamental level, however, insurers have a lot bigger challenges on their hands. In both personal and commercial lines, insurers are struggling to adapt to evolving consumer demands and higher service expectations in an increasingly online economy, with more information sought and transactions conducted over the Web — often via mobile devices. And carriers are striving to incorporate new, unstructured data sources while upgrading their capabilities to leverage the considerable amount of information they already have at their disposal.

## Transformation makes the difference

Bottom line, property and casualty insurers will be hard pressed to achieve more consistent and higher rates of growth if they count on external conditions, usually outside of their control, to harden markets, increase premium volume, and improve investment income, while settling for superficial changes in their systems and standard operating procedures. Instead, companies should be thinking about taking more transformational steps to raise their game above the performance of competitors and the industry as a whole.

**Figure 1. P&C sector-wide results**

Net written premiums were growing faster in the first half of 2013 than a year earlier, but there are indications that price increases are tapering off as capacity has expanded and economic growth has remained relatively modest.



<sup>1</sup> Source: Quarterly recap by ISO and Property Casualty Insurers Association of America

“Rather than wait for a rising economic tide to lift all insurer boats, carriers should consider transforming the ways they do business to compete more effectively regardless of market conditions, as well as to differentiate their brands as part of the leading edge,” according to Gary Shaw, U.S. Insurance Leader for Deloitte LLP.

“Transformation is required because insurers need to keep pace with changes being implemented not only by traditional competitors, but also new players from outside the industry,” Mr. Shaw added. For example, hedge funds are pouring capital into the reinsurance market, changing the competitive dynamic, while some technology firms are entering insurance distribution directly rather than merely providing software and support for traditional players.

As a result, insurers will likely need to be more adaptive in their thinking, their culture, and their strategic approach if they expect to be market leaders in an increasingly competitive, more tightly segmented, and ultimately customer-driven environment.

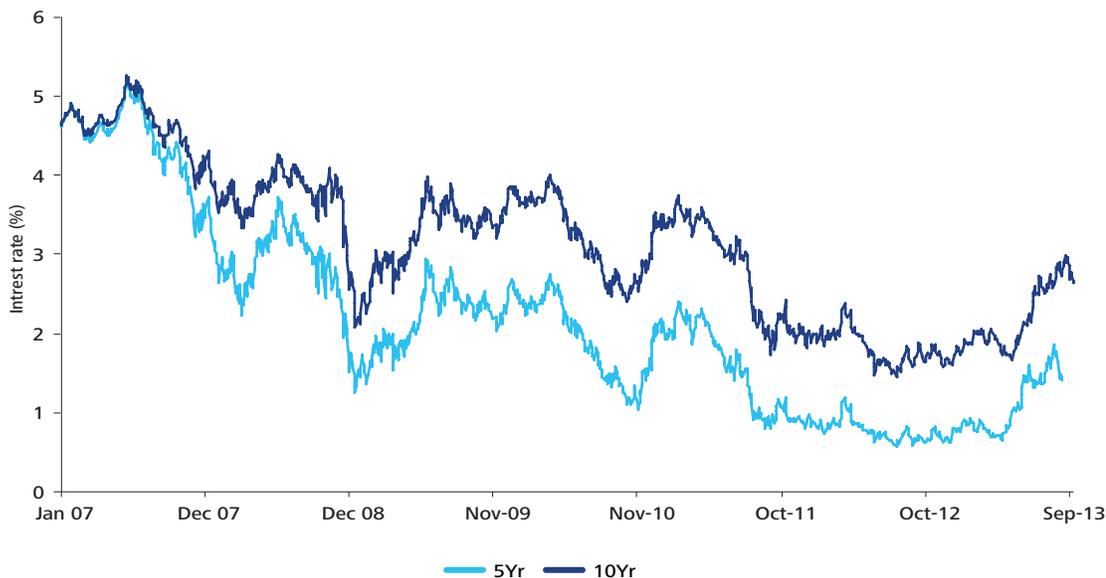
In the six sections of this outlook, we’ll examine a few of the key issues keeping insurance executives up at night, how those issues might develop in the year ahead, along with a “bottom line” recap offering some suggestions on how insurers might respond.

Our outlook makes clear that macro- and microeconomic trends will challenge insurers to shake up the status quo and develop new systems and processes throughout their internal organizations and external distribution chains.

For this reason alone, these are actually exciting times for insurance executives, who have a chance to reinvent their business models so that the industry doesn’t merely survive, but prospers at a time when innovation and change is an ongoing journey, although likely never a final destination.

**Figure 2. U.S. Treasury yield curve rate**

Persistently low interest rates have undermined insurer investment returns over the past few years and put pressure on carriers to price their products for an underwriting profit.



Source: US Department of Treasury. "Historical Treasury Rates." <http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-LongTerm-Rate-Data-Visualization.aspx>. 2013.

## New capital entering industry might rejuvenate M&A activity



Although premium volume has been on the rise for the past couple of years thanks to higher rates and more exposures to insure in a still sluggish but growing economy, pricing power for property and casualty insurers began to deteriorate in the second-half of 2013, likely making organic growth more challenging for many carriers in 2014.<sup>2</sup>

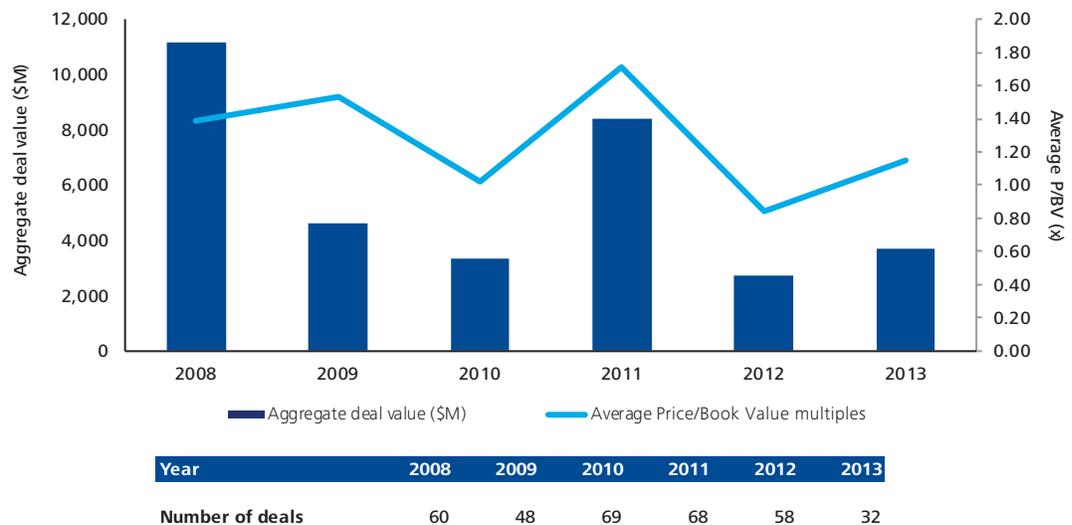
One major factor restraining rate increases in the commercial property market has been the influx of capacity from non-traditional sources, as capital market players seeking higher returns, as well as uncorrelated risks for their portfolios, have poured funds into the reinsurance business. Hedge funds have launched new reinsurance vehicles, while demand from individual investors, as well as from institutions such as pension funds, has fueled expansion in catastrophe bonds.

This additional capacity has increased competition and undermined the ability of established reinsurers to raise, or in some cases even maintain rate levels. Consolidation might be one solution to drain excess capacity from the market, perhaps overcoming a number of headwinds that have been a drag on insurer M&A activity over the last couple of years.

For example, from the buyer perspective, many publicly-held carriers have been allocating excess capital to initiate stock buybacks, viewing such a strategy as more capital efficient and potentially less problematic than buying part or all of another company's operations. However, there are indications that the impact of such a strategy may be playing out, perhaps prompting renewed interest in boosting share value by making an acquisition instead.

**Figure 3. M&A trends for property and casualty**

While overcapacity might soon drive additional consolidation, particularly in reinsurance, many carriers have been initiating stock buybacks with excess capital rather than attempt riskier acquisitions, although indications are this trend may be playing out.



Source: SNL Financial

- Transactions represent U.S. and Bermuda Property & Casualty Insurance Underwriters making acquisitions on a global basis.
- Transactions grouped by the year they were announced. 2013 captures the year to date period as of Oct. 4, 2013.
- Deal multiples represent closed multiples, unless the transaction is still pending its closing.

<sup>2</sup> "Personal lines moderating, no signs of hardening," National Underwriter, Sept. 4, 2013.

### **What's new for 2014?**

The additional capital that has flowed into the industry is likely creating excess capacity, undermining pricing leverage, and inhibiting organic premium growth. This might end up rejuvenating what has turned out to be a rather tepid merger and acquisition environment for insurers.

A big question is whether new capital market players will exit reinsurance if a series of disaster losses and/or a high-severity event undermines investor confidence. However, if the new investors entering the market have staying power, reinsurance is the first area that might be ripe for consolidation, as carriers look to redeploy some of their excess capital by taking over competitors.

From the buyer's perspective, primary carriers are likely to focus on M&As building scale or capabilities. Mid-size and regional companies might turn out to be the most active in the M&A market, as they look for opportunities to enlarge their footprint and take their game to the next level.

Additional consolidation in the agent/broker community is expected as well, as intermediaries move to increase their market access and leverage.

### **The bottom line**

With valuations rebounding of late, overcapacity dampening organic growth, and stock buybacks perhaps heading for a decline, be prepared for a more dynamic mergers and acquisition market in 2014. The time may be ripe for insurers to reexamine their strategic direction and determine how an M&A might help them achieve their growth targets. Consider the types of companies (and pieces of companies) that might align with a carrier's strategic objectives, as well as how to effectively absorb them so they are accretive to earnings.

## Evolving consumer preferences could shake up insurance distribution



The distribution landscape is morphing into an increasingly diverse mosaic. Web-based aggregators, agencies, and auction sites are providing online insurance shoppers with multiple quotes from different carriers. Emerging trends are likely to drive even more fundamental changes next year and beyond.

One is the growing interest of carriers and online intermediaries in selling commercial insurance coverage direct to small-business consumers over the Web. Another is the continuing expansion of usage-based auto insurance, driven by telematics. A third is the launch of private exchanges to sell health insurance. Each of these initiatives has heavy data analytics and technology platform hurdles to clear if insurers hope to capitalize on the growth potential in these developing markets.

Meanwhile, product development is evolving as well to cover the rising threat of hacker attacks and the potentially crippling exposures facing businesses (including insurers) if the security of personal client information is breached, prompting more sophisticated cyber-liability policy and risk management service offerings.

In addition, growing awareness of broader environmental liabilities and the increased attention being paid to “green” construction and manufacturing is spurring new product development and additional premium volume for mainstream and specialty insurers alike.

Another climate-change-related opportunity could emerge as reform legislation requires the National Flood Insurance Program to explore the possibility of increasing private carrier participation in this troubled, but potentially huge property insurance market.

### What's new for 2014?

A survey of small-business consumers by Deloitte found that about one-in-five would be very likely to buy insurance direct from carriers over the Web if given the opportunity, while another third would be somewhat likely to take the plunge, with differences seen depending on the respondent's age and size of business (Figure 4). The surveyed sample of likely online consumers does expect a discount of 10-15 percent in return for buying direct, but that is in line with the commission levels often paid to agents and brokers.<sup>3</sup>

“While few opportunities exist today in the United States to buy small-business coverage direct over the Web, other than in commercial auto and professional liability, that's very likely to change. In 2014, more carriers may follow the lead of their counterparts both in the United Kingdom, where many lines are already routinely sold over the Web, as well as here in the United States, where direct-sales initiatives are underway or under consideration,” according to Donna Schlegel, a director with Deloitte Consulting LLP.

In the meantime, while property and casualty insurers may not start marketing products through private health insurance exchanges this coming year, 2014 might be a good time to begin exploring the potential for such piggyback sales. Implementation of health insurance exchanges will introduce tens of millions to Web-based insurance transactions for the first time, leaving open the possibility to cross-sell additional types of insurance while consumers are already online.

<sup>3</sup> Voice of the small-business insurance consumer: Are buyers ready to take the direct sales route?, Deloitte Development LLC, 2013.

**Figure 4. How likely are small businesses to buy insurance online, direct from carriers?**

Half of small businesses surveyed by Deloitte said they would be at least somewhat likely to buy their commercial insurance direct over the Web, with the smaller companies most likely to go that route.



Very likely Somewhat likely Not very likely

Source: Voice of the Small Business Insurance Consumer Survey, Deloitte Center for Financial Services, March 2013

Yet this trend may not necessarily lead to disintermediation, should an “advice gap” prompt consumers to seek the help of insurance professionals in navigating the new exchange system and in clarifying their coverage options. In fact, many major brokers are already taking the initiative by setting up their own private exchanges, while new online agencies offering comparative quoting services are also making a bigger impact in both personal and commercial lines.

On a more fundamental level, however, property and casualty insurers with medical components in their policies may have to adapt to some negative fallout from health care reform. If demand for medical services soars because millions more people will have health insurance, that could increase wait times to see a doctor, take a diagnostic test, or get rehabilitative services, which could increase the severity of indemnity claims for workers’ compensation carriers by delaying a return to the job. And if medical providers are overtaxed by the expected flood of new patients, their exams might be more hurried or delegated to non-M.D. practitioners, which could increase the risks facing malpractice insurers.

On the other hand, the fact that more people have health insurance might remove the temptation for the currently uninsured to file fraudulent workers’ comp claims to get medical care for non-work-related injuries. And a healthier population more likely to get preventative care could lower frequency and severity for both workers’ comp and malpractice insurers.

#### **The bottom line**

Insurers interested in selling small-business insurance or other coverages direct to consumers will be upgrading their underwriting, pricing, and customer service systems, fueled by predictive analytics. Even carriers not choosing to go direct should consider system enhancements to counter those that do go that route, as well as to meet higher customer service expectations being raised by online sellers in other industries. Carriers should also start getting their strategies in order and consider aligning with private health insurance exchange partners they think might be a good match for cross-selling property and casualty products, or risk being left out in the cold when the trend does catch on.

## Regulatory uncertainty leaves insurers in a holding pattern

Despite lots of talk this past year about the potential impact of various U.S. and foreign regulatory reform initiatives on the insurance industry, 2013 saw relatively few significant changes directly affecting property and casualty carriers.

One involved the implementation of a new risk-based capital charge for catastrophe risk. Beginning with the reporting period covering year-end 2013, the latest version of the proposal would allow companies to use whatever risk model and assumptions they employ internally in preparing the catastrophe-risk-charge report filing.

But on many other fronts, the industry has been stuck in a waiting mode this year, resulting in a great deal of regulatory uncertainty that makes strategic planning extremely challenging. For example, concerns remain about the renewal of the Terrorism Risk Insurance Program (TRIP), which expires in December 2014.

### What's new for 2014?

The Federal Insurance Office (FIO) came out in December with its long overdue report on how insurance regulation could be modernized and improved.

"The FIO report in some respects is a challenge to state regulation but overall is not likely an immediate threat to state supremacy," says Howard Mills, chief advisor for the Insurance Industry Group at Deloitte LLP. "Most of FIO's recommendations require Congressional action, which is not expected anytime soon, or is a call to the states to make changes, which FIO cannot now compel. The bottom line is that there is likely to be little immediate impact, but continued uncertainty over a slowly evolving regulatory landscape shaped by how the states and federal government interact."

The report was a mixed bag for the property and casualty industry. It called for federal regulation of mortgage insurers. It also said the FIO would work with states to establish pilot programs for rate regulation in order to maximize the number of insurers offering personal lines products. This latter initiative may be a positive for insurers operating in the most restrictive environments — those requiring prior approval of rate filings, for example — and may open the way for more and faster product innovation.

On the other hand, the report takes direct aim at the use of some underwriting and rating factors, including marital status. The FIO will "study and report on the manner in which personal information is used for insurance pricing and coverage purposes." According to the FIO, risk factors in an age of widely available personal data may be "an appropriate subject for binding, uniform federal standards." Consumer groups have harshly criticized the use of some such personal factors in auto insurance rate and coverage determinations recently.

The FIO report also called for states to identify, adopt and implement best practices to mitigate losses from natural catastrophes, an apparent positive for both the property and casualty industry — which has worked to encourage states to improve building codes and implement other mitigation initiatives — and consumers, who could benefit from lower costs and more protective structures.

Meanwhile, what to do in response to TRIP's looming expiration could dominate insurance-related headlines throughout the year, unless Congress overcomes its current gridlock and agrees to renew the program in time to spare buyers from having to go bare on the exposure or pay a much higher premium for coverage.



“Even if Congress renews TRIP, if changes are made to the cost-sharing formula or to nuclear, biological, chemical, or radiological coverage requirements, that could require insurers to reevaluate the potential cost,” according to Mr. Mills. This in turn could end up having just as big an impact on the availability and price of commercial insurance in highly concentrated markets as if the program had not been renewed, at least in the short term.

Insurers are also bracing themselves for a court ruling on the challenge to a regulation issued by the U.S. Department of Housing and Urban Development that would use “disparate impact” — the doctrine that an unintentional act could be considered discriminatory if it has a disproportionate effect on a protected class — as a metric for evaluating insurance performance. “Were the courts to allow the use of the disparate impact standard, insurers may well be forced to reevaluate valuable underwriting factors used to offer or price insurance, despite their predictive accuracy,” according to Mr. Mills.

One significant looming accounting change involves contracts under U.S. Generally Accepted Accounting Principles (GAAP). The Financial Accounting Standards Board (FASB) has proposed, among other changes, to have most property-casualty companies use the premium allocation approach to insurance and reinsurance products, including a separate liability being recorded when a claim is incurred. FASB began its review after the comment period closed in October 2013.

#### **The bottom line**

Regulatory uncertainty will continue to be the norm in 2014. One casualty of the ongoing gridlock in Congress could be terrorism insurance for property owners, although insurers should be prepared for a potential regulatory backlash if the industry moves in force to limit or abandon the coverage, or to effectively price consumers out of the market.

More kitchen table consumer concerns, such as the availability and affordability of auto insurance, could come under a harsh spotlight, so carriers should prepare to defend their underwriting and pricing practices. Insurers have addressed this to some extent through new products such as pay-as-you-drive coverage. But carriers should expect an increased market conduct focus by state insurance regulators conscious of the industry’s exemption from the purview of the federal Consumer Financial Protection Bureau.

## Transforming finance to become internal business partners

Finance is more often being asked for decision support and strategic advice within insurance companies, prompting transformation initiatives to evolve the function into an internal business partnering role by strengthening its link to broader enterprise goals, such as product focus and capital deployment.

In an increasingly complex business environment, finance functions at financial services organizations are expanding their capabilities to support the introduction of new products and markets, cost reduction initiatives, and efforts to achieve appropriate risk-adjusted returns, according to a Deloitte survey of chief financial officers.<sup>4</sup>

Business partnering in this context can be defined as the role that finance will assume to both support and challenge insurer initiatives. It is a shift from stewardship to strategic thinking, with finance looking to create value by improving the quality of business decisions while helping realize the highest financial value for a particular initiative at what is considered to be an acceptable level of risk. The challenge is for finance to develop into an effective internal business partner to enhance strategy formulation and execution, while maintaining its stewardship and control capabilities.

Carriers are also looking to prepare for new financial information demands from regulators, likely to be generated by the National Association of Insurance Commissioners' (NAIC) Own Risk and Solvency Assessment initiative, the European Union's Solvency II directive, and other such calls for data and analysis. Finance will likely play a major role in scenario planning, stress testing, and other efforts to comply with new oversight requirements.

A number of insurers continue to face challenges in finance when it comes to adapting legacy systems to meet these evolving data demands. Deloitte's research into business partnering among finance leaders in 11 industries found that while technology is a key enabler, it can also be an obstacle in effectively supporting the business, thus driving the need for transformation efforts. The survey showed that even when finance business partners have the correct data, they often have to spend significant time rationalizing it to make it relevant for strategic business purposes. Indeed, 57 percent ranked "finance systems inhibiting access to data" as a top-three barrier.<sup>5</sup>

### What's new for 2014?

A growing number of carriers are poised to move further along the finance maturity curve so they may become true internal business partners, while also upgrading their systems and capabilities to provide the data and insights required to meet increasingly stringent regulatory demands.

Under Deloitte's "Four Faces of Finance" framework<sup>6</sup> (Figure 5), "Stewards" tend to emphasize protecting company assets and ensuring compliance with financial regulations, while "Operators" generally support efficient finance operations and service delivery. However, business partnering likely requires taking the finance function to the next level. "Strategists" help determine business direction and align financial strategies, while "Catalysts" look to proactively stimulate behavior to achieve strategic as well as financial objectives.

Therefore expect finance functions at a growing number of insurers to move towards partnering, and in the process become a more integral contributor as Strategists and Catalysts in key business activities — including target-setting, forecasting, capital investments, risk management, and governance. The drivers are two-fold, one being regulatory demands for stress testing and scenario planning, with the other being the need to better integrate finance into overall business partnering.

To reach this higher stage of transformation, finance will likely need to collaborate more closely with other functions, such as risk management, than may have been the case historically. To accomplish this, insurers will look to bring together financial and operational data, which often is not within the current reach of finance. As a result, they will also likely need greater information technology support to produce the types of data being sought for both business purposes and regulatory needs.

Talent can be a differentiator. Carriers looking to bolster their finance capabilities may need to develop or recruit those with certain critical competencies, such as commercial acumen and decision-making skills, strategic thinking, and the ability to influence and even challenge enterprise decisions.



<sup>4</sup> CFO Signals™ Survey, Deloitte LLP, 2013.

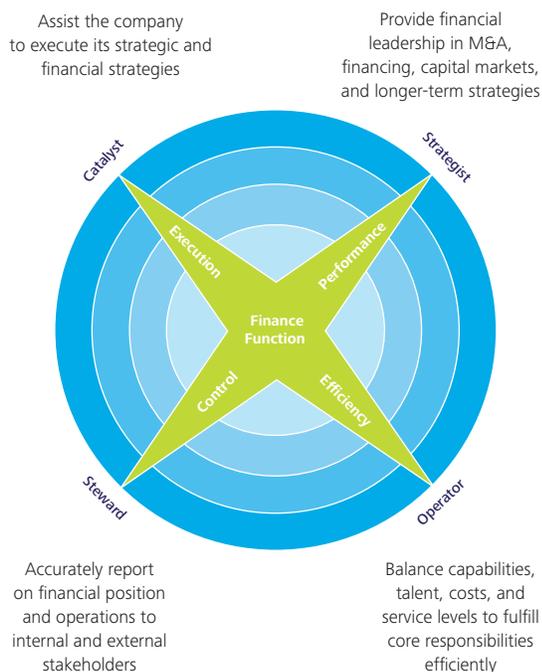
<sup>5</sup> Finance business partnering survey: changing the focus of finance, Deloitte LLP, 2012.

<sup>6</sup> Unlocking the potential of Finance for insurers, Deloitte Development LLC, 2013.

As companies transform financial processes, the lines of business, risk, and tax departments will look to reevaluate and improve the availability and quality of information, especially in relation to non-SEC/financial reporting data, as they seek to bolster business intelligence, predictive analysis, risk management, and capital allocation.

In addition, there could be an increased utilization of outsourcing in the finance area for more routine activities to facilitate a greater focus on core strategic, business partnering priorities in-house.<sup>7</sup> Insurers also have an opportunity to reexamine and streamline their control processes to better align with the new COSO<sup>8</sup> framework — to ensure that any risks emerging from increased outsourcing and use of third-party services are well managed.

**Figure 5. The four faces of the finance function**



Many carriers likely reside at the early stages of finance transformation, focusing on improving the roles of Steward or Operator, centered on building infrastructure, improving efficiency, and cutting costs through outsourcing or shared services, but that is likely to change as more seek to enhance the Finance function's role into full-fledged internal business partners.

**The bottom line**

Insurance players should take a more holistic approach to their finance transformation initiatives, exploring how finance could create greater value by playing the role of a Strategist and perhaps Catalyst in decision-making on broader company challenges. The resulting finance-model design should be flexible and scalable, to remain in sync with an insurer's evolving business model and operating philosophy.

Without sacrificing their stewardship role, finance leaders should develop a plan to align with higher value enterprise activities so they may become more valuable business partners with their internal clients. To evolve in this direction effectively, partnering competencies should be built or imported into finance — an area where recruitment and development efforts have traditionally focused more on acquiring or developing technical proficiency rather than a broader business skill set.

<sup>7</sup> 2012 Global outsourcing and insourcing survey, Deloitte Consulting LLP. (The survey results are based on all major industries and regions with 15 percent of participants from FSI.)

<sup>8</sup> COSO is the Committee of Sponsoring Organizations of the Treadway Commission, a joint initiative of five private-sector organizations that develops frameworks and guidance on enterprise risk management, internal controls, and fraud deterrence.

## Insurers look to upgrade core operations, people power

Faced with uncertain growth prospects over the past few years, many carriers have focused on organizational restructuring and system upgrades to improve efficiency, reduce operating costs, and shore up their financial results.

Yet more complex operational challenges likely must be overcome if insurers are to keep up with emerging trends, such as the expansion of telematics and the introduction of direct sales of small-business insurance. To capitalize on these and other innovations, carriers will likely need to create more analytics-driven, straight-through processing systems.

To remain competitive in this environment, carriers will consider transformational initiatives to improve enterprise-wide agility in their operating models and to leverage customer, underwriting, and pricing data for sustained competitive advantage over the long term.

One of the more common efforts of this kind has lately involved claims transformation, which goes beyond just installing a revamped technology system. Tapping new analytic algorithms to better assess claims, correlate them against a wider array of customer data, and more effectively red-flag potential anomalies that could indicate fraud is a very important element of the transformation, and is becoming table stakes for such reorganizations. The end game is to hasten turnaround time, improve productivity, and reduce costs while upgrading the customer experience.

However, carriers are starting to realize that an essential part of the systems transformation journey is evolving the roles and upgrading the capabilities of affected personnel. In some cases, bolstering the claims staff's skill levels may prove to be integral to long-term performance improvement. The same could be said of other transformation efforts as well.

This raises a more fundamental problem and spotlights a critical organizational deficiency that could hinder the operational effectiveness of many insurers — that is, the shortage of skilled talent to facilitate innovation, implement transformation projects, and improve productivity.



“Despite relatively high unemployment, there is a shortage of qualified workers steeped in specialized skills insurers crave, including advanced analytics, predictive modeling, mobile technology, and other abilities in high demand, leaving the industry to cope with a talent paradox — having millions unemployed, but few ready, willing and able to step in and help insurers transform their operations,” according to Andy Liakopoulos, a principal in the Human Capital Practice of Deloitte Consulting LLP.

Insurers are competing not just with one another for such highly-skilled talent, but with other financial services sectors and many other industries as well, particularly those in the high-tech fields. Exacerbating this problem are overall demographic concerns, with a generally older and aging insurance work force in many important functions.

The rapid adoption of data-driven initiatives has widened the talent gap for insurers, given the economy-wide demand for individuals with analytical skills. Therefore, attracting, developing and retaining employees with such specialized capabilities remains a significant hurdle to overcome and a potential differentiator for those that do.

Beyond recruiting challenges, “a silo mentality limits the ability of many carriers to effectively create alternative career paths for those with skills that might be adaptable for other, more pressing needs within the company,” added Mr. Liakopoulos, who leads Deloitte Consulting LLP’s U.S. Talent Strategies practice.

### What’s new for 2014?

Carriers will continue to focus more on transformation initiatives in claims, underwriting, and other core systems to improve their agility and flexibility. Emphasis will be placed on simplifying and reducing cycle time to improve customer satisfaction, expanding straight-through processing until a human touch is required, as well as establishing more direct access to the customer.

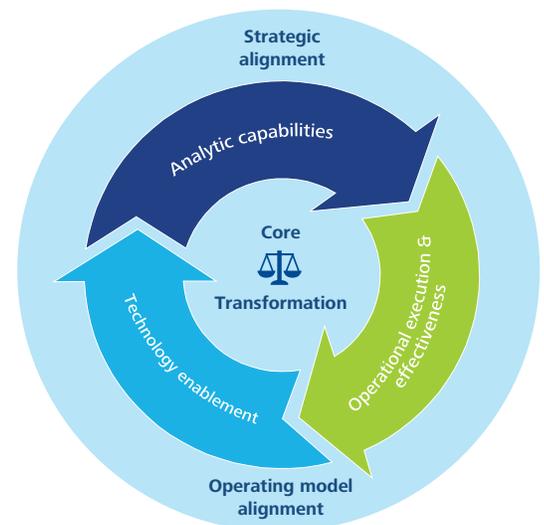
Improving flexibility in the operating model requires a holistic approach, with greater integration of capital allocation, business processes, technology infrastructure, and human resource management strategies across the organization.

On a more fundamental level, insurers will likely consider adjustments to their employment model. “To overcome the talent paradox, insurers may broaden recruitment strategies by determining the basic competencies required for hard-to-fill positions, and then actively target candidates not just from outside the company, but beyond the industry as well — for example, hiring out-of-work teachers with math skills who can be retrained for a career as an actuary or in analytics,” according to Mr. Liakopoulos. “They may also look to bolster continuing education and cross-training programs.”

In addition, insurers may adjust their performance management and compensation systems to focus more on developing the talent they already have in-house. The goal will be not only to improve retention of highly-skilled, experienced employees at a time when competition among carriers for talent will likely be fierce, but to more proactively encourage and facilitate flexibility and productivity among their entire work force.

Instead of viewing career growth as strictly a vertical progression within a business unit, carriers might consider creating a more flexible career lattice, with interested and deserving individuals given the opportunity and rewarded for extending their functional skills laterally across multiple lines of business, or being redeployed to departments where their specialized skills may be more valuable.

**Figure 6. Core system transformations on the rise**



The end game in claims transformation is to hasten turnaround time, improve productivity, reduce fraud and cut costs while upgrading the customer experience.

**The bottom line**

High on the agenda should be transformation initiatives throughout the organization to achieve not just greater efficiency, but flexibility and agility as well. At the same time, insurers should recognize that changes in systems alone may not improve their competitive potential without a corresponding shift in personnel capabilities and deployment. Talent recruitment and career development should be redefined to staff insurers with the skill sets required to fuel the transformations already underway and still to come.

## Tech can level the playing field as carriers cope with data challenges

Data, which is the lifeblood of insurance, is experiencing exponential growth. That should be a boon for the industry, but in order to win the information “arms race,” carriers are being challenged to upgrade their data management capabilities in underwriting, pricing, and claims, while grappling with a host of related technological and liability challenges along the way.

“Developing strategies to better integrate and leverage existing and emerging data sources within legacy technology platforms and capabilities is proving to be a daunting challenge for many in the industry,” says Neal Baumann, Deloitte Consulting LLP’s global insurance sector leader. “As more and more carriers look to execute strategies to drive performance and reduce risk via leveraging data and analytics, insurers should be prepared to make the tradeoffs needed to develop capabilities that they believe will provide them with strategic advantages. In some cases this might lead to the need to revisit and modify traditional business and operating models.”

Take the rapidly evolving field of telematics, for example. Pioneered over a decade ago, telematic offerings have expanded rapidly in the personal auto market, yet some carriers say adoption by drivers remains relatively underwhelming largely due to concerns about the potentially negative impact on pricing and privacy. In addition, it takes a lot of investment to realize the benefits of telematics, and smaller carriers are particularly challenged due to insufficient historical data for underwriting and pricing purposes.

In the meantime, as insurers accumulate more and more data, the threat of cybercrime and growing privacy exposures are likely to keep insurance company chief information officers up at night as they ponder more effective risk management techniques.



### What's new for 2014?

More economical options on the near horizon will potentially propel telematics to the level of an industry disruptor. Large players with the in-house ability to harness sufficient data to effectively underwrite usage-based policies may have a competitive advantage for the moment, but the playing field might soon be leveled for smaller and regional competitors thanks to external information aggregators.

Deloitte, for one, has been working with an industry association to provide a centralized repository to supply carriers without their own critical mass of data with the information they will need to underwrite and rate usage-based auto products. At the same time, alternatives such as this may provide insurers with the ability to avoid having to put telematic devices into vehicles by connecting via a policyholder’s personal mobile device instead.



More economical information-gathering options on the near horizon may soon propel telematics to the level of an industry disruptor, with the playing field being leveled for smaller and regional competitors by external data aggregators.

However, apps to facilitate usage-based auto insurance is just one mobile initiative insurers are likely to adopt as they look to become a more regular part of their customers' everyday online lives, while differentiating themselves with additional value-added services. Look for insurer apps to more routinely employ time and location data to issue customized safety alerts, vendor recommendations, and perhaps even loyalty program discounts.

As more data pours into insurance carrier systems, security and privacy may become an even bigger enterprise risk management challenge, rising on the agenda of senior management and boards. The threat landscape will continue to evolve as cybercrime transforms, which means insurers should constantly update their responses. There also may be speed bumps raised by regulators as opportunities arise to collect, underwrite, and price policies based on customer data from additional sources.

"Insurers should also be aware that analytics and technology development projects may provide the opportunity for potential tax credits, making such projects less costly once this factor is accounted for," according to Chris Puglia, a partner at Deloitte Tax LLP.

#### **The bottom line**

Technology transformations across the enterprise will be high on insurer radars in 2014. Digital strategies that more closely engage policyholders and improve customer experience are no longer aspirations, but necessities in a mobile-driven culture and economy. More sophisticated smartphone apps and aggregated data bureaus will level the playing field for smaller-sized insurers and challenge bigger carriers to raise their game and differentiate their brands on usage-based insurance. Insurers not interested in adopting telematics will need to develop strategic responses to add value in other ways and discourage customer attrition. To maintain their reputations and avoid regulatory and liability challenges, insurers will have to go the extra mile to assure data privacy and security.

# Where should insurers go from here?

## Tweaks versus transformations

Running a property and casualty insurance business is rarely smooth sailing, and not just because the potential for a major catastrophe costing billions of dollars always seems to loom ominously on the horizon.

Yet the last few years have been particularly difficult for those occupying C-Suite positions, as more fundamental issues are threatening not only short-term results on their balance sheets, but challenging the long-term viability of their operating models as well.

“There are usually tactical steps insurers could take to make a short-term course correction, and tweaks can often be implemented to adjust systems and processes,” according to Gary Shaw, U.S. Insurance Leader for Deloitte LLP. “But to capitalize on emerging opportunities instead of being undermined by the disruptive changes likely to alter the competitive landscape, top insurance executives should be more predisposed towards bigger-picture innovations.”

## Disruptions already underway

There has already been significant organizational disruption going on among a growing number of insurers. Many have made large-scale investments in technology, replacing core systems for claims, policy administration, and finance. Their chief challenge now is how to effectively leverage the new systems they’ve put in place and maintain their momentum with additional innovations in personnel, products, and culture.

Others who have up until now made ad-hoc, shorter-term adjustments should be considering how a bolder investment in more transformational upgrades might better position their companies to remain competitive not just in 2014, but for the remainder of what is likely to be a tumultuous decade ahead.

## Some thoughts for the road

Among the questions insurers should be asking themselves in the year ahead:

- How might insurers be more innovative to counteract the trend towards a slow-growing and commoditizing market? Which new types of products and consumer segments might insurers serve to expand the overall premium pie, rather than battle over the business already being written?
- Would a strategic merger or acquisition be a more effective way to deploy excess capital and make up for difficulties in generating organic growth? Might a deal be the ticket to achieving scale, rationalizing operating costs, and expanding market share? Or would a takeover make more sense in terms of importing new products, markets, capabilities, or talent?
- How can insurers achieve the maximum return on investment for their core transformation projects? Is there a way to dovetail an enhancement of individual talent and skill sets so that tech system improvements are bolstered by greater human capital capabilities?
- How might an insurer gather and synthesize new types of information to gain actionable insights, such as from telematics or social media? And how can the organization improve the way it correlates the data it already gathers in the normal course of business across lines and processing systems?
- How should insurers respond to the growing “do-it-myself” mentality of today’s online consumer? Might it make sense for certain agency carriers to do more business directly with customers? If so, how can an insurer’s processes and systems be adapted to accommodate an intermediary-free exchange, and how could such efforts complement rather than compete with an existing sales force? For those committed to one particular distribution option, how can they defend their books of business against those with different or multiple alternatives at their disposal?
- How do insurers deal with the strategic implications and

cost of regulatory uncertainty? Can they better integrate regulatory considerations into strategic scenario planning, involving all C-Suite members rather than just compliance and risk management? Could nimbleness in responding to regulatory requirements be turned into a competitive advantage?

- How might insurers alter the way they recruit and develop talent so that they close the widening skills gap in their organizations? And how can they create a more flexible career path to retain their most valuable employees while being positioned to quickly move individuals to areas within the company where their skill sets are most urgently needed?
- What can insurers do to evolve their finance operation into more of an internal business partner to help identify and capitalize on growth opportunities, without neglecting the function's traditional stewardship and compliance role? What skill sets need to be developed or imported to make such a transformation a reality?

Once again, the competitive differentiator for many might come down to flexibility and innovation. The economy is rapidly evolving into a more virtual, mobile-

driven, self-service world, with higher expectations for customer service over multiple platforms. Boundaries between industries are beginning to blur for many Web pioneers, with insurance perhaps providing a tempting target for brand extensions among online retailers and aggregators.

Yet it's the insurance industry that has the experience, expertise, and brainpower in transferring risk. The question is which carriers will have the vision and ability to proactively anticipate and adapt to new market realities. Those that do are more likely not just to survive, but to prosper as they reposition themselves against traditional as well as emerging competitors.

"Whatever the challenge, this outlook indicates that simply maintaining the status quo is likely no longer a sound business strategy no matter which operating model is employed by a particular insurer, given the macro- and microeconomic trends buffeting the industry from all sides," says Gary Shaw, U.S. Insurance Leader for Deloitte LLP.

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### The Center wishes to thank the following Deloitte client service professionals for their insights and contributions to this report:

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### The Center wishes to thank the following Deloitte professionals for their support and contribution to the report:

Rachel Moses, Senior Marketing Specialist, Deloitte Services LP  
Courtney Scanlin, Insurance Marketing Leader, Deloitte Services LP  
Aditya Singh, Assistant Manager, Deloitte Services India Pvt. Ltd.



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