

Striving to sustain growth

Insurance industry summary

*Key industry findings
from 14th Annual Global
CEO Survey*



Insurance industry summary

The global economy is still recovering from the worst economic crisis in 75 years, as many countries grapple with the aftermath of the recession. So we set out to uncover how chief executive officers (CEOs) are approaching growth during a time when sustainable economic growth is far from certain. We surveyed 1,201 business leaders in 69 countries around the globe in the last quarter of 2010, including 57 insurance CEOs, and conducted further in-depth interviews with 31 CEOs.

The PwC 14th Annual Global CEO Survey documents a surprising level of confidence in this environment; chief executives are nearly as confident of growth this coming year as they were in the boom years before the crisis. The survey also revealed where CEOs see growth coming in 2011, and how they are going to achieve it. In 'Growth reimagined: Prospects in emerging markets', we show how CEO confidence is being driven by targeted investments in particular emerging markets – often far from home.

We also identified three strategic focal points to achieve that growth: innovation, talent and a shared agenda with government. These three business imperatives have always had their place on the CEO agenda. But now, with their worst fears about the crisis behind them and an emerging recovery ahead, CEOs are adopting new attitudes and approaches, tailored to dealing with the issues of the multi-speed global recovery that they hope is underway.

Striving to sustain growth

Insurance CEOs are emerging from the financial crisis with renewed confidence about their growth prospects. Yet, generating profitable growth is going to be challenging for many companies in the face of tight margins, mounting regulation and the fragile economic environment within many developed markets. Insurers are also finding it difficult to communicate the value being created within their businesses and hence to achieve the share prices they believe their performance should merit. For many insurers, overcoming these challenges is likely to require a transformational shift.

The insurance CEOs taking part in our survey are upbeat about the future. More than half (56%) are very confident about their company's prospects for revenue growth over the next three years and virtually all the rest are reasonably confident. That makes them more optimistic than CEOs in almost every other sector.

This is also an industry in transformation. Forty-six percent of insurance CEOs – more than the percentage in other financial services sectors – have fundamentally changed their strategy over the past two years. Another 44% have made at least some modifications. The primary driver is customer demand, though economic growth or uncertainty, regulation and attitudes to risk are also important factors (see Figure 1).

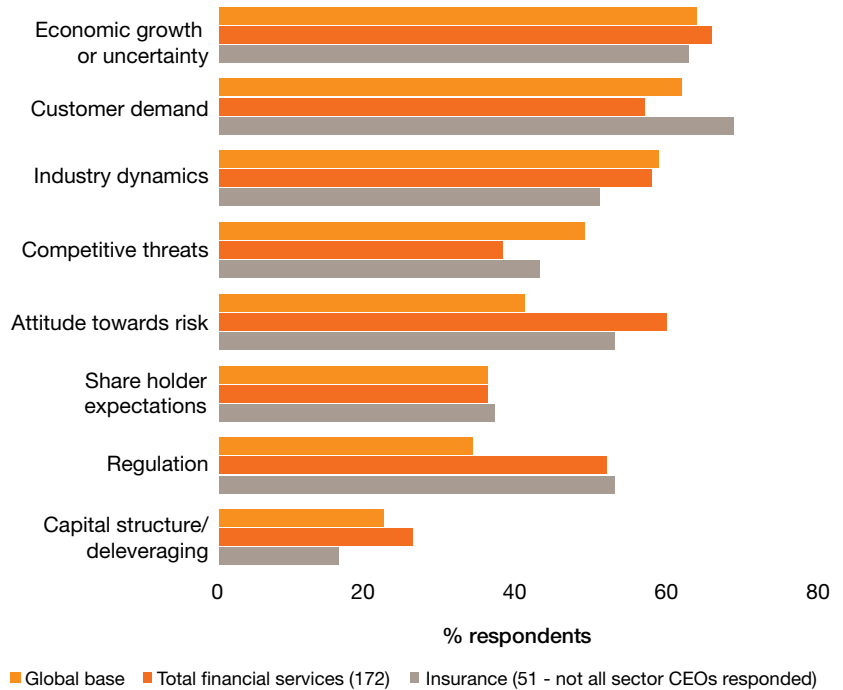
Opportunities for innovation

Ageing populations, not just in the developed world, but in Asia as well, are opening up significant opportunities for life insurers. The financial crisis has created further openings by accelerating the decline in defined benefits pension plans and putting further pressure on public pension provision.

Smart use of technology is set to be one of the key differentiators in a sector that has long been dogged by aged and inefficient legacy systems. More than 60% of the insurance CEOs in our survey see investment in IT as a key driver of their growth initiatives. Technology could be invaluable not only in improving efficiency and cutting costs, but also in enabling companies to

Figure 1: Strategic influences

Q: Of the following eight factors that may be changing in your business, which have significantly influenced your need to change your strategy?



All respondents who stated 'changed in fundamental ways' or 'somewhat changed'

Base: All respondents (1,201)

Source: PwC 14th Annual Global CEO Survey 2011

broaden their distribution, enhance their customer insight and capitalise on cross-selling opportunities. Indeed, one of the most important perceived benefits of IT investment for the insurance CEOs in our survey was the ability to leverage innovations such as mobile devices and social media.

Cost control will clearly continue to be critical across the sector as a whole – 58% of insurance CEOs plan further cost control initiatives over the next 12

months. Thirty-nine percent plan to outsource a business process, though 18% are looking to bring a previously outsourced function back in house, suggesting that success in this area continues to be mixed.

London Market businesses, Bermudian and global reinsurers ('wholesale insurers') are facing a continuing decline in rates across most lines. With relatively few major loss events in recent years, many wholesale insurers have built up a surfeit of capital, which is adding to the downward pressure on prices. In a recent PwC report examining the way forward for reinsurers, several CEOs suggested that it would take a loss event akin to a Hurricane Katrina to propel premium prices up again¹.

The immediate dilemma for these wholesale insurers is what to do with the surplus capital. Returning it to shareholders is one option, though this may simply reinforce the perception that wholesale insurance is a low-growth sector and hence deter investment. Insurers are also facing pressure from regulators to hold more capital.

While growth in many mature markets may be slowing and returns on some of the more commoditised lines may continue to be low, there are ways for wholesale insurers to generate more favourable and sustainable shareholder value. This includes developing the scale and efficiency to provide volume products efficiently and cost-effectively. They could also get closer to the client, rather than waiting for the broker to deliver the business. This would enable

them to build up a better understanding of the client's specific risk management demands and develop carefully tailored solutions to meet them. Some could take this further by exploring demand trends and identifying niches that would allow them to profitably leverage their risk analytics and specialist expertise. There may also be opportunities to package insurance risk in a form that better meets the needs of capital providers.

The underlying opportunity is to extend the borders of insurability and provide clients with effective ways to deal with a complex and uncertain risk environment. Nearly 70% of the insurance CEOs in our survey believe that their clients will look to them to provide product innovation, and this will be a key driver of their growth strategy over the coming three years.

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¹ 'Way Forward: Innovation and differentiation in the reinsurance industry – the CEO perspective', PwC (September 2010).

Fast-growth markets

In the longer term, 56% of the insurance CEOs in our survey believe that emerging markets will be more important than developed markets to their company's future; only 44% see their home markets as offering high growth potential. China tops the list of countries targeted for growth (cited by 28% of insurance CEOs), followed by the US, Brazil and India (all 19%). The potential within emerging markets is evident. For example, life premiums in China, Brazil and India all grew by more than 10% in 2009, compared to a fall of about 15% in the US². Insurance penetration is only around 3% of GDP in China and Brazil, and 5% in India, compared to 8% in the US².

However, tapping into these markets may be difficult. While organic growth is clearly an option, it can take a considerable amount of time to build a market presence and be in a position to compete with well-established local players. Mergers and acquisitions could offer a faster way to build scale. A quarter of insurance CEOs expect their company to make a cross-border acquisition over the next 12 months, with Asia being the primary focus of attention (43% are planning an acquisition in this region). However, curbs on majority foreign control remain in a number of significant growth markets, including China and India. This helps to explain why 47% of insurance CEOs fear that the

protectionist tendencies of national governments could impede their plans for growth. Insurers from developed countries could also face pressure from the governments in their home territories to target their investment towards the local economy, which may reduce the capital that can be directed overseas. Seventy percent of insurance CEOs accept that they will need to actively support new government policies that promote 'good growth'.

The final hurdle is securing sufficient talent to meet growth aspirations. More than half of insurance CEOs see the availability of key skills as a significant threat to their growth plans. Tapping into the limited pool of talent within many emerging markets could be especially problematic. With local talent in short supply, many companies are struggling to keep pace with salary escalation among local professionals or face the potentially prohibitive expenses of large-scale secondments. A third of insurance CEOs think understanding and forecasting the availability of talent in emerging markets is a key challenge. A similar proportion pointed to difficulties in deploying experienced talent globally. These challenges will only mount, as companies expand further – highlighting the need for a more strategic approach to training and nurturing talent locally. The vast majority of insurance CEOs recognise this; more than 90% are planning to revamp their strategy for managing talent. However, it is notable that a greater proportion plan to deploy more staff on international assignments (49%) than to develop talent locally (40%).

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Managing perceptions

Of all the threats to growth highlighted by insurance CEOs, over-regulation is by the far the most significant (cited by 79% of insurance CEOs). There is a real danger that insurers in many developed markets could be forced to comply with more stringent regulatory demands that have been primarily designed for banks. Such a development could be especially challenging for European insurers already facing the introduction of a new capital adequacy regime under Solvency II. Most insurers came through the financial crisis strongly and those that incurred significant losses did so primarily as a result of their non-insurance operations. Nonetheless, many governments and regulators have come to see insurance as posing a systemic risk and thus in need of similarly draconian controls and capital requirements to those facing banks. It is therefore crucial that insurers make a concerted effort to lobby the authorities and stress the vital contribution their industry makes to the economy and society as a whole.

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Implementing Solvency II will be a huge challenge, but it is also an opportunity for forward-looking companies to put their businesses on a more competitive footing. This includes developing the risk insights needed to capitalise on market openings that less well informed firms may miss or be reluctant to pursue. A clear example is guaranteed life policies. Many customers now want guarantees in the wake of the uncertainty created by the financial crisis, but some insurers may want to scale back such business because of the potentially high capital requirements

under Solvency II. Firms with a clear understanding of their risks are well placed to offer these products more economically and thus to move into the market as others exit.

Solvency II could also provide a further catalyst for rationalising complex business operations and developing more efficient capital structures, which could reduce both capital requirements and compliance costs. Companies that take advantage of these opportunities will be able to offer lower prices and use their funds more flexibly as a result.

The underlying challenge for all insurers is how to communicate their performance and prospects in a clear, credible and consistent way. Many insurance CEOs believe that their company's share price fails to reflect the strength of the business – largely because most analysts and investors find it difficult to make sense of the complexities of insurance and because there is little comparability in the way results are disclosed.

Our research confirms that analysts are particularly keen to see more information about risk and the level of cash being generated within companies. The planned overhaul of IFRS for insurance contracts is a chance to put insurance disclosure on a more coherent and comparable footing, though it may be several years before the details are finalised. In the meantime, companies that can explain the link between their strategies, the risk they have assumed and the cash they expect to generate will have a valuable opportunity to increase their share prices.

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The winners will be those insurers that can develop a clear strategy for value creation and market differentiation and communicate how this strategy differs from their competitors and why it deserves to be valued differently. They will also be able to attract the talent and develop the risk analytics to enhance innovation, price their products more competitively and capitalise on market openings.

Standing out from the pack

The fact that insurance CEOs are so confident about the prospects for growth is encouraging. The problem is that many companies are finding it difficult to deliver favourable and sustainable returns. This is, in turn, making it difficult to secure investment for growth. The winners will be those insurers that can develop a clear strategy for value creation and market differentiation, and communicate how this strategy differs from those of their competitors and why it deserves to be valued differently. There will also be those that can attract the talent and develop the risk analytics to enhance innovation, price their products more competitively and capitalise on market openings.

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