Willis Towers Watson

The UK life insurance market 2017-2018

Evolution, with a capital 'R'

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Over the centuries insurers have generally had the luxury of evolving their businesses, implementing developments gradually over time. However, the recent fast-moving nature of political, economic and market conditions resulted in a highly fluid business environment for UK life insurers in 2017, creating pressures to respond more rapidly: more revolution than evolution.

As we begin another new year, we review the factors that contributed to that fluidity and how we've been helping clients address their own change agendas. We also look forward to some of the pressing issues that will have a significant bearing, in our view, on the degree to which individual insurers will continue to be able to adapt.

Admittedly, insurers can do little to influence some of the drivers of change. The ripple effects from the result of 2017's snap election and the uncertainty about the terms of Brexit are simply the 'facts of life' for all UK businesses.

But whether embedding Solvency II into business as usual, taking the first steps to transition to IFRS 17, incorporating product and pricing innovation, taking steps to radically simplify the business, or responding to the opportunities and threats of InsurTech, UK life insurers will benefit from demonstrating the same level of preparedness for what lies ahead as many have already shown in orienting themselves to recent developments.

If you would like to talk to us about any of the subjects featured in this review, please do speak with your Willis Towers Watson contact or email ICT@willistowerswatson.com.

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2017 in review: turbulent waters

While recognising that every UK life insurer is affected in different ways by prevailing market conditions, there are a number of common themes that we explore below.

The first theme is of margin compression, with many insurers increasingly striving to adopt strategies that successfully navigate these turbulent waters. At the very least, economic, demographic, competition and technology have shone a spotlight on the shape and performance of certain portfolios leading to a heightened level of disposals and acquisitions as insurers rightsize their business in order to secure future success. Optimising and improving responsiveness of pricing, reinsurance, cost management, and risk and capital management, have become endemic to running a successful business.

Against this backdrop, insurers have not had the luxury of focusing solely on these strategic imperatives. Burgeoning regulatory and accounting requirements have sustained the pressure on insurers, increasing costs and absorbing board time. With firms and regulators still getting to grips with Solvency II, the announcement of the implementation date for IFRS 17 has further muddied the waters, threatening to confuse investors as to the real sources of value in the insurance industry.

In this section, we look at some of these issues in more detail and highlight some of the major client assignments we worked on over 2017, for example, reducing the time taken for a year-end reporting process by more than 70%, along with an 80% reduction in the cost.

We want to benefit from sophisticated, dynamic pricing models and optimisation techniques in the same way that non-life companies have

For over a decade, general insurers have used dynamic price optimisation techniques to flex prices for specific sets of customers, yet the use of these techniques is still limited in the life market.

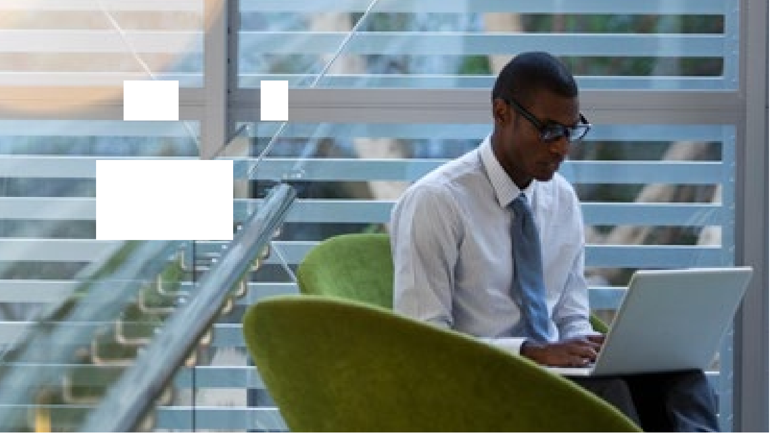
Price optimisation adds explicit consideration of customer demand and elasticity to the traditional 'pure risk' component. In a competitive marketplace, being able to predict the impact of price points based on a detailed understanding of customers is a big opportunity for life insurers, allowing them to more effectively manage capacity and balance this with demand. It could also help identify areas of the market currently not 'converting'.

One UK life insurer, with whom we've worked to introduce dynamic pricing, was able to achieve a 3% margin increase in its protection book from a first-phase project that restricted its freedom to vary pricing whilst it gained familiarity with the techniques. Since then, it has started to implement our Radar Live software (which is used by over 50% of the UK motor insurance market) to hand control of reprices from the IT department back to the pricing team and further improve pricing agility.

Simplification of existing business, particularly with-profits, is increasingly viewed as a necessity, but such change has to serve the interests of all stakeholders

The case for simplification of with-profits funds has become increasingly compelling in light of the contracting market, low interest rates, the changing nature of contracts, the associated governance and management costs, and the Financial Conduct Authority's desire for greater transparency and better value for money for existing policyholders.
The aim of a good simplification exercise is to find the 'sweet spot' that meets policyholders' needs for greater flexibility, transparency and certainty out of their policy; regulators' concerns about solvency and around the fair treatment of legacy customers; and shareholders' requirements for better customer outcomes and returns, and reduced complexity, time and cost of administering the business.

We have been advising and supporting one major UK life insurer with an extensive portfolio in this area, with the ultimate aim of merging and simplifying its multiple funds and products.



We need to get a proper handle on mortality and how it varies by individual circumstances

Recent mortality rate reversals in some developed countries illustrate how sharper analysis of customer longevity is becoming all the more valuable. For example, by explicitly modelling disease-based processes of mortality and their drivers, using medical data for the parameterisation supplemented by input from medical experts about likely future trends in their specialist fields, (re)insurers can fine-tune their assumptions. This approach can also help with product design, helping to create and price new products to fit particular customer segments.

Using both the Willis Towers Watson Pulse Model for this purpose and the Postcode Mortality Tool, we've supported a number of clients on assignments such as M&A transactions, the validation of key pricing assumptions in a critical illness book, a report on future age and gender mortality trends for a bulk annuity writer, and a review of high net worth term assurance pricing.

Our technology and systems need to be powerful, flexible and nimble enough for our future business needs

The myriad of issues affecting UK life businesses, a sample of which are included in this document, are increasing the demands and strains on existing IT systems. Companies are finding that a complex web of legacy systems often gets in the way of, or at the very least slows, progress against objectives.

Recent Willis Towers Watson software releases make use of new interface technologies, the evolution of the cloud and software-as-a-service delivery options, and reflect a general market direction towards greater flexibility in IT capability. Among the software being adopted by UK life insurers is Unify, Willis Towers Watson's enterprise risk and actuarial systems integration platform, and RiskAgility, our life modelling suite that recently won the 2017 Actuarial Post Software of the Year Award.

Finance and reporting transformation isn't just advantageous, it's essential

Layers upon layers of new financial, regulatory and risk management obligations have mounted up for UK life insurers in recent years. With production timetables having already been considerably compressed by the Solvency II quarterly reporting requirements, 2017 saw companies having to prepare the annual Solvency and Financial Condition, and Regulatory Supervisory reports for the first time. IFRS 17 implementation is also now on the horizon.

The increasing time involved and the common impacts of resource inefficiency, over-reliance on key individuals, inadequate controls, governance and validation, and rising costs are all reasons for companies to undertake finance transformation. In the case of one UK-based multinational, we are working with them on an ongoing project to radically transform their operating environment, exploit new technologies and drive substantial cost out of the business. One branch of this project has, to date, reduced the effort required to perform the end-to-end actuarial process by around 80% and significantly upgraded the process governance and auditability.

After all the effort preparing for Solvency II, let's get some real business value from our investment

Implementation of Solvency II has typically involved a big investment of time and money. As compliance moves to more of a business-as-usual footing, there is still further work to embed processes and models, not only to satisfy use test requirements going forward, but to achieve tangible business value from the investment.

In this vein, we've been active over 2017 on several projects, including supporting firms to enhance their asset and liability management, through implementation of unit matching, for example.

Let's make sure that our risk management framework is geared to business needs

While downside risk management can add value, to the extent that it prevents losses, a lot of the value of risk management comes from informed strategic risk management (from guiding risk taking to risk transfer). A solid risk management framework is the bedrock on which an ability to add any value to risk management is built, with components such as the risk culture, an agreed risk appetite, stress and scenario testing, robust governance and a capital allocation framework – all supported by practical action plans for actually dealing with a risk situation.

Fundamental to making good strategic decisions is the risk appetite framework, and over the past year we have worked on the ground-up redesign of a new risk appetite framework that addresses the idiosyncrasies of the Solvency II balance sheet, rather than simply representing a lift and drop of that previously employed under the ICA regime, for a UK-based composite insurer.

That's a potted view of some actions being taken across the industry in 2017, but what of 2018...?

What to expect in 2018

It's certainly looking as though 2018 will show little sign of any let-up for UK life insurers. The nature of the challenges will be much the same as in 2017, although priorities may well need to change based on individual company circumstances. The stark reality is that the time for strategic activities will remain limited, so insurers' boards will need to challenge themselves and their businesses to continue to drive forward value-adding activity in addition to the mountain of work that is more compliance-focused.

Brexit – dealing with uncertainty

Companies will of course have to do their best to navigate their way around Brexit, based on how the negotiations proceed. Key questions when planning for the business and financial implications include:

- How much, if any, business has been underwritten under EU passporting rules?
- Is any business longer tail in nature (and therefore carries the risk that the company may be unable to legally pay out on those policies unless a solution is found)?
- If so, do companies have a legal entity in Europe into which they can transfer the liabilities via Part VII Transfer? This can take a year or more.
- If they don't have a suitable legal entity, where should they ideally set one up (taking into account factors such as location of the majority of the business, regulator attitudes, labour laws, tax)?

Seek competitive advantage from analytics

Data clearly plays a major part in all modern insurance businesses. Yet, despite all the hype and attention on big data, we believe there is significant scope for UK life insurers to benefit from the under-explored potential of more basic analytics – in areas such as pricing, claims, customer relations, and risk and capital management. A logical starting point is to identify the data and the actionable analytics required to achieve the main business objectives. Rather than scouring the data universe from the outset, untapped sources of internal data can often make a significant difference. And whatever companies are already doing or going to do, they will of course now need to factor in the EU General Data Protection Regulation (GDPR).

Our advice for technology and big data initiatives in any insurance organisation is encapsulated in three important pointers:

- Use cases, not technology, should lead the way.
- If you're going to fail, fail fast.
- Involve subject matter specialists early on.

The role of InsurTech

InsurTech businesses are undoubtedly part of the wider technology and analytics picture, even if those making a significant impact on the UK market are few in number right now. More advances will come, however, to potentially change market dynamics, so life insurers will need to keep monitoring and updating their overall technology strategy. Recent trends have demonstrated shifting perceptions of the benefits of established players working more closely together with some of the young upstarts. In the short-term, the biggest areas of potential for cooperation appear to involve:

- Customer relationships.
- The customer experience.
- How enhanced analytics and technology contribute to product features and satisfaction, e.g. pricing (wearables), claims handling.

Product reviews, especially on with-profits

As much as some new or variations on products may emerge, existing product portfolios will continue to need to be closely examined for the levels of returns, capital efficiency, service cost and new policy sales. Notably, even after the small rise in UK interest rates, many with-profits funds, including larger ones, will be falling well short on a number of those marks.

Simplification exercises can range from narrowly-focused options, such as expense agreements, outsourcing or communications exercises, to the more complex and far-reaching conversion of with-profits policies, to unit-linked or non-profit policies.

Deal making that optimises capital

Our latest analysis of global insurance M&A, conducted with Mergermarket, indicated that macroeconomic, demographic and regulatory pressures mean that capital optimisation is taking on added importance in companies' acquisition, merger and divestment strategies. Consistent with that trend, sellers of portfolios may need to support buyers' demands for a more comprehensive analysis of a range of potential capital implications arising from a deal, including factors such as the diversification benefits and the likely reaction of regulators.

IFRS 17 – no gain without some pain

One issue that will almost certainly require more attention from all UK life insurers over the next year is preparing for IFRS 17, the new global accounting standard that will come into effect on 1 January 2021.

The 2021 live date is deceptive. The reality is that, due to the need for comparatives, companies that report on a calendar-year basis will have to be able to produce a complete set of numbers for 2020 as well. For insurers looking at performing a full dry run, realistically, that means being ready as early as 2019. From the progress we've seen across the market, failure to start accelerating the pace of preparations in 2018 is likely to lead to panic, inefficiency and poor decisions in 2019 and 2020. Notably, business and strategies that work under Solvency II may look completely different in the IFRS 17 world, so the time for talking and contemplation of the tasks involved is over.

Transformation 2.0

Taking account of the diverse and growing information needs, further pressure for finance transformation seems inevitable. How long can patched-up process and systems solutions, many developed pragmatically to meet a specific purpose, hold up? For example, actuarial and reporting work streams that may seem tight now haven't finished shrinking yet. We believe more widespread automation is the way forward.

Aside from the speed benefits, a key rationale for automating more standard processes can be to improve the reliability of the results taking advantage of improved control and governance, to save money, and consistently, to free up expert time to add more value to the business. That said, not everything can be done at once, so any transformation project is likely to involve finding the appropriate balance and sequencing of acceleration and improvement of tasks. And since achieving finance transformation is next to impossible without good and adequate technology, companies will need to structure their IT to move with their requirements.

Know your regulator

One way to offset the onerous regulatory and reporting workload, in our view, will be to more proactively manage relationships with regulators, rating agencies and other key financial stakeholders. Increasing efforts in this area have already been evident in some client projects.

This partly involves developing a clearer understanding of what information agencies need, and how and by whom technical documents will be used and assessed. Basic steps that should almost immediately improve matters include eliminating information silos so that the right information reaches the people who are charged with making persuasive cases to external bodies. And then, when the information has filtered up, ensuring that submission documents aren't contradicted by internal supporting documentation. Insurers that can avoid just being in response mode when dealing with regulators, rating agencies and analysts will find it worth the effort, in our view.

Less focus on compliance in risk management

More widespread operationalisation of risk management frameworks should play a significant role in transformation plans. Our 2017 survey of UK life insurers' risk management practices showed that most companies are at least gearing up for the challenges of moving risk management beyond the needs of regulatory compliance, even if some have only taken tentative steps on the journey.

So we anticipate less time checking the checked, and more time acting as an agitator of innovation across the business. Perhaps the greatest areas of focus will include broadening the use of analysis tools and technology, and the closer interaction of risk functions with key departments such as underwriting and claims. One interesting trend from our survey is that companies that said they had reshaped their risk function in the last three years employed nearly double the percentage of actuaries in their risk teams (excluding compliance). Moreover, those companies were nearly four times as likely to have an actuary as their CRO.

A question of priorities

As this not-so-small selection of topics would suggest, we see plenty of opportunities for UK life insurers to grow and transform in an uncertain operating environment. Inevitably, this will involve some difficult choices for UK life company business leaders in order to prioritise and capitalise upon them, but one choice that is almost certainly not sustainable in today's market is to push them aside.

Dates for your diary

Life European Actuarial Directors' Forum
15-16 March 2018, Budapest

Life2018 Conference
20-21 June 2018, London

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