The Midterm Elections and Beyond

With 60 days until the midterm elections, the post-Labor Day election forecasting has begun in earnest. While several variables can still influence the ultimate trajectory of the election, a national climate where President Trump's approval rating is mired in the high 30s/low 40s and the average Democratic lead on the generic ballot is 8.4 points continues to point to a base case where Democrats win control of the House and Republicans retain control of the Senate. However, Republicans retaining a small majority in the House is still a possible outcome, and the Democrats have a path to a Senate majority if they run the table of toss-up elections.

The midterm elections are a critical opportunity for voters to express their views on the current performance of Congress and the Trump administration, with the outcome playing a defining role in how Congress and the administration move forward for the next two years. A blue wave that brings the Democrats into the House majority will empower the anti-Trump and GOP critics to push back on the previous two years of governing. **Despite any legislative prerogatives coming from Democratic leadership, the likelihood that any meaningful legislation that is not considered "must pass" is enacted and signed into law in the next two years remains remote.**

House Democrats and Senate Republicans are unlikely to agree on controversial issues like drug pricing reform and pay-fors for infrastructure spending, as policy messaging will quickly turn to the 2020 presidential elections. **As such, a divided Congress will mean greater legislative gridlock and ramping up of executive actions on items like trade and drug pricing when possible from the Trump administration. Without needing support from Republicans, Democrats will seek to focus on the administration and conduct investigations into Trump as the progressive base seeks accountability rather than compromise with the president and GOP.** How far-reaching and theatrical these investigations go will be determined in large part by the makeup of Democratic leadership and committee chairmanships as well as any final report from the Mueller investigation.

While all eyes are on the midterm elections, behind the scenes planning is ramping up among congressional leadership to stake out a possible legislative agenda for 2019 and 2020, with *Axios* earlier this week detailing what a potential Democratic majority in the House would focus on should they take over in November. Such internal planning will continue among Democrats and Republicans, along with intra-party debates and positioning for leadership posts. Meanwhile, staff departures, like that of White House Counsel Don McGahn, will likely accelerate after the midterm elections, creating another iteration of staff turnover that could leave the White House ill-prepared for the challenges of dealing with an opposition party in control of at least one chamber of Congress unless the administration can bolster its legal staff by year's end

The Post-Labor Day Campaign Push

House

According to FiveThirtyEight's recently launched House forecast, Democrats have a 77 percent chance of picking up the 23 seats necessary to become the majority party. *Politico*'s new race ratings predicts the "House leans in favor of the Democrats." Meanwhile, individual race forecasters like the Cook Political Report show Democrats starting with a base of 182 solid seats and Republicans with 150 solid seats. From there, Democrats are defending 13 competitive seats and Republicans are defending 90 competitive seats (38 of which are rated as a toss-up or worse). Political analysts have noted that such a high number of competitive Republican seats denotes that the House GOP is facing the highest relative seats-at-risk-to-margin ratio (152 percent) compared to midterm elections in 1994, 2006, and 2010 when the House majority changed parties. This means Democrats have a higher margin of error than in past efforts in converting competitive seats into wins for them to take the majority.

A wide path for the Democratic quest for 23 seats is through open and vacant seats left by Republicans. A record 38 Republican House incumbents chose not to seek reelection this year, with several more leaving vacant seats due to scandal. While most of those seats are in reliably red congressional districts, the Cook Political Report has 13 of these seats as rated toss-up or worse for the GOP and only nine rated as Lean/Likely for the GOP. Without the incumbency advantage, Democratic candidates for many of these seats stand a good chance of winning.

And while there are several strong Republican incumbents in swing congressional districts that Democrats face an uphill climb of ousting, there are good number of Republican incumbents who are struggling to organize against formidable Democratic challengers. According to *Politico*, Democrats in 56 House districts surpassed Republican incumbents in Q2 fundraising this year, with 16 of these challenges having more cash-on-hand too.

Senate

As challenging as the national climate is for Republicans, Democrats will not only need a blue wave, but a blue *tidal* wave to overtake the high ground Senate Republicans have in 2018. Republicans now hold a razor-thin 51-49 edge over Democrats in the Senate – a net of just two seats will give Democrats control of the upper chamber in November. But of the 35 Senate seats up for election this year, 26 are held by Democrats and Independents aligned with Democrats, while only nine are held by Republicans. Many of these seats, like in Indiana, Missouri, Montana, North Dakota, Tennessee, and West Virginia are in the heart of Trump country, where the Republican challengers are actually seeking to nationalize the race and make it a referendum on supporting the Trump agenda. These Republicans will also receive the bulk of the resources and attention from Trump himself, as he ubiquitously campaigns in person and via Twitter over the coming weeks.

Taking the latest election ratings from Cook Political Report, Sabato's Crystal Ball, Inside Elections, and RealClearPolitics (RCP) polling averages, eleven of those Senate seats held by Democrats, and just four of those Senate seats held by Republicans, will be competitive to varying degrees in November, something we laid out in detail in a Spotlight Report last month. As opposed to the House, this gives the Senate GOP the best seats-at-risk-to-margin ratio compared to previous midterm elections. *Politico*'s Senate race ratings predicts the "Senate will likely go to the Republicans."

The Base Case: Democratic House/Republican Senate

Come November, the most likely outcome of the midterm elections is Democrats winning the House and Republicans retaining control of the Senate. This base case would also mean a Congress led by Senate Majority Leader Mitch McConnell (R-KY) and a presumed House Speaker Nancy Pelosi (D-CA).

While McConnell's claim to leadership is under no doubt, there has been a whirlwind of chatter about Pelosi's ability to garner the 218 votes necessary to win back the speakership that she relinquished in 2010. A palpable frustration among the House Democratic rank-and-file came to a low boil after the disappointing 2016 elections towards Pelosi and the leadership team -- who have been around longer than most Democratic members have actually been in Congress. Sixty-three Democrats -- nearly one-third of the conference -- voted against her bid to become minority leader after the 2016 election, a margin of victory she could not afford if running for speaker. According to a Gallup poll in June, Pelosi had a dismal 29 percent approval rating, with only 55 percent of Democrats having a favorable view of her. The problem for Pelosi is a generational challenge and a desire for a new face of Democratic leadership, since 78-year-old Pelosi has been leading the caucus since 2003. According to NBC News, at least 42 of the party's nominees for House seats have declared they will not back Pelosi and nine incumbent Democratic lawmakers are on the record opposing her, bringing the total to 51.

Even with this generational concern coming from Democratic candidates and several incumbents, Pelosi remains the odds-on favorite to continue leading House Democrats. The main reason for her relatively strong positioning is not just her fundraising prowess and proven ability to lead a diverse caucus, but the lack of any clear alternative to her leadership post. The one person who was seen as her biggest threat to leadership, Democratic Caucus Chair Joe Crowley (D-NY), will not be in Congress come 2019, as he lost his primary to upstart Democratic Socialist Alexandria Ocasio-Cortez. Without Crowley, Pelosi can credibly claim that she can lead the Democrats for the upcoming two years and transition out of her position in 2020, passing on the mantle then to a new leader.

Pelosi is not waiting for the leadership race to occur to begin planning a potential Democratic agenda in the new Congress. Pelosi on Tuesday wrote a "Dear Colleague" letter to the Democratic rank-and-file that noted, "As we approach the end of this Congress, we must Be Ready for the prospect that we will be in the Majority in January." To that end, Pelosi mentioned three areas where legislation is already being developed: "Lowering health care costs and prescription drug prices; increasing pay through strong economic growth by rebuilding America; Cleaning up corruption to make Washington work for the American people." Part of the Democrats' A Better Deal agenda, these proposals seek to set the legislative agenda for the upcoming two years.

While no detailed plans have come forth about lowering healthcare costs, the Democrats do have a blueprint on tackling drug costs. It includes three focus areas: new enforcement of drug price gouging, allowing Medicare Part D to negotiate drug prices directly, and transparency of excessive drug price increases. In addition, the progressive wing of the Democratic Party will seek to push for "Medicare for All" legislation, which has received the support of the majority of the conference this past year. Though unable to pass the Senate or receive the support of President Trump, the future House leadership will need to find the balance in placating the progressive base while also ensuring that moderates have a voice at the table and are not completely sidelined.

Democrats also have a $1 trillion infrastructure plan that would "rebuild our crumbling infrastructure and create more than 16 million American jobs." The plan from A Better Deal does not specify sources of funding the $1 trillion in spending, though the plan says it will be "stabilizing the Highway Trust Fund" without a specific mention to raising the federal gas tax. A Senate Democratic infrastructure plan from March would offset infrastructure costs through modifying parts of the Republican tax cut law, including raising the corporate tax rate to 25 percent, restoring the alternative minimum tax, and increasing the top individual tax rate to 39.6 percent. It's noteworthy that Pelosi is reportedly "committed to reviving the pay-go (or pay as you go) rule she had during her previous run as speaker," meaning that new spending will need to be offset in the budget, something the Republicans partially waived in their tax cuts.

Pelosi's commitment to fiscal responsibility leaves any sort of compromise with McConnell on something like a major infrastructure package largely in doubt. There was a brief top-down push this year by the Trump administration to pass an infrastructure bill, but even among Republicans, coming up with the necessary pay-fors was a bridge too far. Unlike with tax cuts, where there was a strong impetus from the donor base for Republicans to act, there is little urgency for Pelosi and McConnell to make politically difficult funding decisions (e.g., increasing the gas tax) in order to reach a deal on infrastructure. As such, the one area of common ground that could unite Congress on major legislation has a slim chance of success.

Instead of any serious legislative efforts, a Democratic majority in the House will have the most energy and passion when focusing on Trump. As of now, Democratic leadership is none too keen to support a push for impeachment, at least until the Mueller investigation concludes. In the meantime, if the Democrats take control of the House, they will immediately begin several probes and investigations into the Trump administration, seeking to highlight any perception of corruption within the administration. In talking about future investigations, Pelosi in an interview with NPR this week said, "You will see us use every arrow in our quiver to find the truth about what's happening in public policy, what they're doing to the environment. We see this as a culture of corruption, cronyism and incompetence." According to *Axios*, such investigations will run the gamut from Trump's personal finances and business relationships to policy actions like the Muslim travel ban and family separation at the border.

These investigations will take place largely in the House Judiciary Committee, the Oversight Committee, and the Intelligence Committee. House Intelligence Committee Ranking Member Adam Schiff (D-CA) described the importance of investigations while also making sure it's done in a reasonable manner, saying this week that, "We need to attack the problem of corruption we see in the administration and do our oversight. But Democrats are mindful of the fact that if we want to stay in the majority, we have to show that we are responsibly governing." The challenge for Pelosi, Schiff, House Oversight Committee Ranking Member Elijah Cummings (D-MD), and House Judiciary Committee Ranking Member Jerry Nadler (D-NY) is to preside over an investigation that shines the light on potential corruption of the Trump administration without creating such a spectacle that gives ammunition for Republicans to promote the "witch hunt" narrative that the president has been advocating.

The Other Midterm Outcomes

While a divided Congress is the most likely outcome this November, there is a nontrivial chance that Republicans retain control of both chambers of Congress or, less likely, Democrats take control of the Senate along with the House.

Republican House/Republican Senate

If Republicans are able to hold the House, they will view it as a strong and important endorsement of the Republican agenda and President Trump's first two years in office. In this case, reconciliation will be back on the table as an option for getting around the 60-vote threshold in the Senate. As Vice President Pence recently mentioned, there would be another attempt at repeal-and-replace of the Affordable Care Act (ACA), something the Republicans failed at, albeit by just a single vote in the Senate. A second iteration of tax cuts, namely, extending the tax cuts on the individual side for a few more years while making some fixes to the first round of tax cuts could also be an option for reconciliation with the potential for some drug pricing reforms to be included as pay-fors. Finally, Republicans would also take a close look at tackling welfare reform, something that retiring House Speaker Paul Ryan (R-WI) has always wanted to accomplish, but did not have the bandwidth to achieve this year in a meaningful way.

In terms of the makeup of the Republican caucus, Senate Republicans who were critical of the president, including Senators Bob Corker (R-TN), Jeff Flake (R-AZ), and the late-Senator John McCain (R-AZ) will no longer be in office. In their place would be candidates who were elected (Mitt Romney being the exception) in large part thanks to the campaigning and support of the president. A more pro-Trump Republican makeup will be even more evident in the House. Speaker Ryan has a working relationship with the president, but it's clear that the speaker has several issues with the style of the president. But Ryan, along with several moderate Republicans critical of the president, are retiring at the end of this year or are facing tough reelections, leaving the future House leadership in more Trump-friendly hands. The two leading contenders to replace Ryan, House Majority Leader Kevin McCarthy (R-CA) and House Majority Whip Steve Scalise (R-LA) are effusive in their praise of and relationship with the president. Additionally, Rep. Jim Jordan (R-OH), one of Trump's biggest supporters from the House Freedom Caucus, is running for speaker. Jordan's chances of actually becoming speaker are slim, but he could parlay any support he garners into a leadership post, bringing one of the biggest Trump allies into a position of power. All of this would mean even less scrutiny of the Trump administration, leaving the president even more inclined to ridicule the Mueller investigation without fear of congressional repercussions. All the while, House Republicans would continue the investigations against perceived injustices done to Trump and conservatives.

Democratic House/Democratic Senate

A blue wave in the midterm elections that gives the Democrats both the House and Senate would be seen as a major rebuke of Trump from all corners of the country. Democrats would have the power of reconciliation to advance several of their agenda items, though they would not have the votes necessary to override a veto. Democrats would be emboldened to investigate Trump, block several of his nominees in the Senate, and seek tough negotiating positions in spending talks. This includes a major fight around Trump's border wall and action around protections for Deferred Action for Childhood Arrivals (DACA) recipients. All of this would lead to a greater showdown between Trump and Congress, leading to an increased risk of a lasting shutdown.

The Trump White House Post-Midterm Elections

A post-midterm election scenario where Democrats have control of the House is not a scenario for which the Trump administration has prepared. The dynamics and organization of the White House has always been one of chaos and lacking adequate staffing, but this may only be magnified if Democrats win the House. According to a report by *the Washington Post* last week, "President Trump's advisers and allies are increasingly worried that he has neither the staff nor the strategy to protect himself from a possible Democratic takeover of the House, which would empower the opposition party to shower the administration with subpoenas or even pursue impeachment charges." A similar report was done by the *Associated Press* last week as well. In particular, Trump's legal team is already understaffed, with White House Counsel Don McGahn leaving in the fall. An understaffed and unprepared legal staff will create immense headaches for the White House as investigations from a Democratic House ramp up and potential impeachment talks develop.

But it's not just McGahn and members of the White House legal team that are seeking an exit after the midterm elections. People like Press Secretary Sarah Sanders and Chief of Staff John Kelly are unlikely to stay on into the New Year. Cabinet secretaries like Defense Secretary Jim Mattis and Attorney General Jeff Sessions could also step down or get fired. The continuing record turnover of White House personnel leaves Trump with a shrinking orbit of staff that he will trust less and less. Any replacements are unlikely to hold the same caliber of the prior Trump appointments, creating an environment where the president is even more unshackled by the burdens of process and bureaucracy. In terms of policy, this will likely necessitate greater use of executive actions to accomplish the president's policy priorities, as he has already demonstrated a penchant for pursuing with respect to trade and drug pricing policies.

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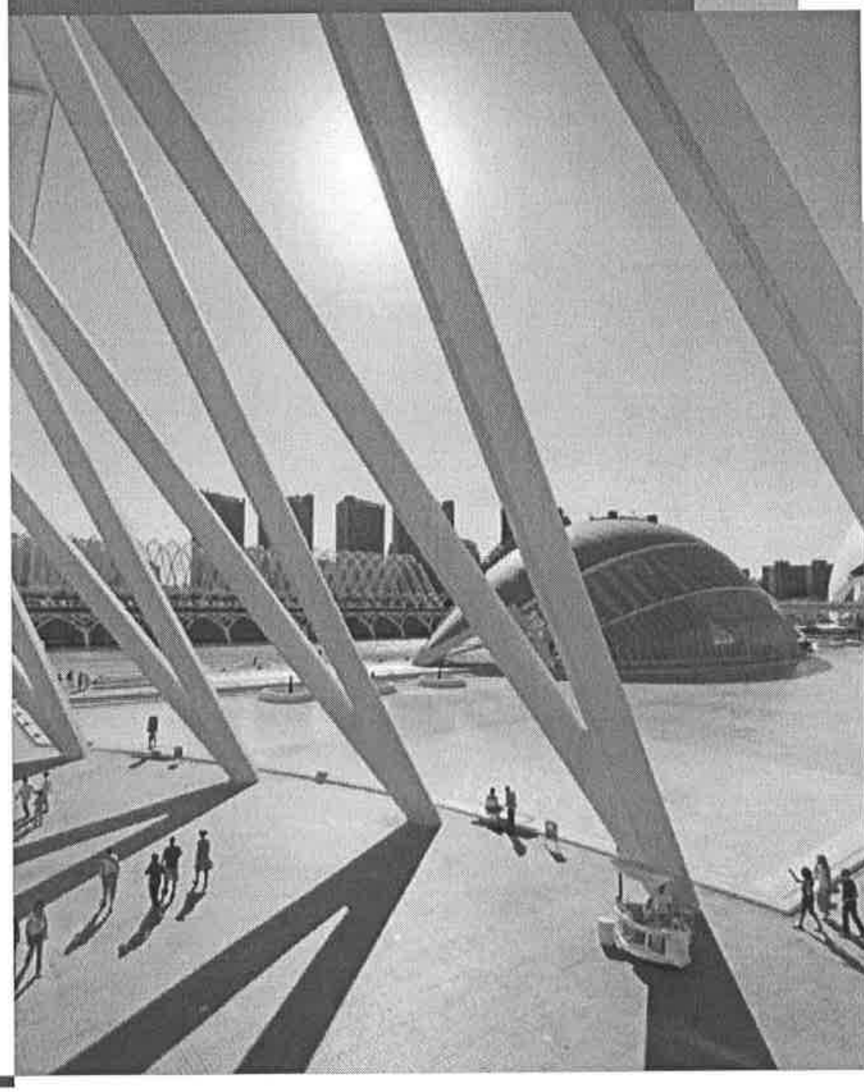
Insurance 2020: Turning change into opportunity

Insurers who anticipate and plan for change can create their own future

January 2012



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Introduction

The future may be hard to predict, but need not be hard to prepare for. Insurers are grappling with the tough new business, investment and regulatory environments that are emerging from the financial crisis.

The industry, however, also faces far broader challenges. Demographic shifts, the rise in power of the emerging markets and changing customer behaviour will all help shape the sector's longer term future.

Insurers who can anticipate and plan for change can create their own future. Others who are 'fast followers' will need to be agile enough to recognise the leaders and adopt similar strategies. The 'survivors' are likely to be focused on short-term performance. ***Which one are you?***

In this report we take a two-stage approach (see Figure 1) to help you address this key question and to develop a strategy to exploit the opportunities the future holds:

1. **Analysis of the key market drivers.** We have conducted extensive research to develop a set of future scenarios. We have based our research on an 'outside-in' scenario planning analysis that takes into account the impact of global social, technological, environmental, economic and political factors (STEEP) across three major insurance industry sectors – personal, commercial and life, annuity and retirement. We take into consideration more than 30 different drivers that could potentially impact insurance, globally. (We describe in this document the drivers, but due to space limitations do not cover each one in depth.)

2. **Implications for insurers' business models.** Our second stage is an 'inside-out' business design analysis, which evaluates the impact of these different scenarios on developed and emerging market insurers' strategies. We also consider the changes you could make to your business design to avoid risks and maximise opportunities. The business design framework can help you to exploit the data and insights in this study, and tailor them to your specific strategic direction and unique capabilities.

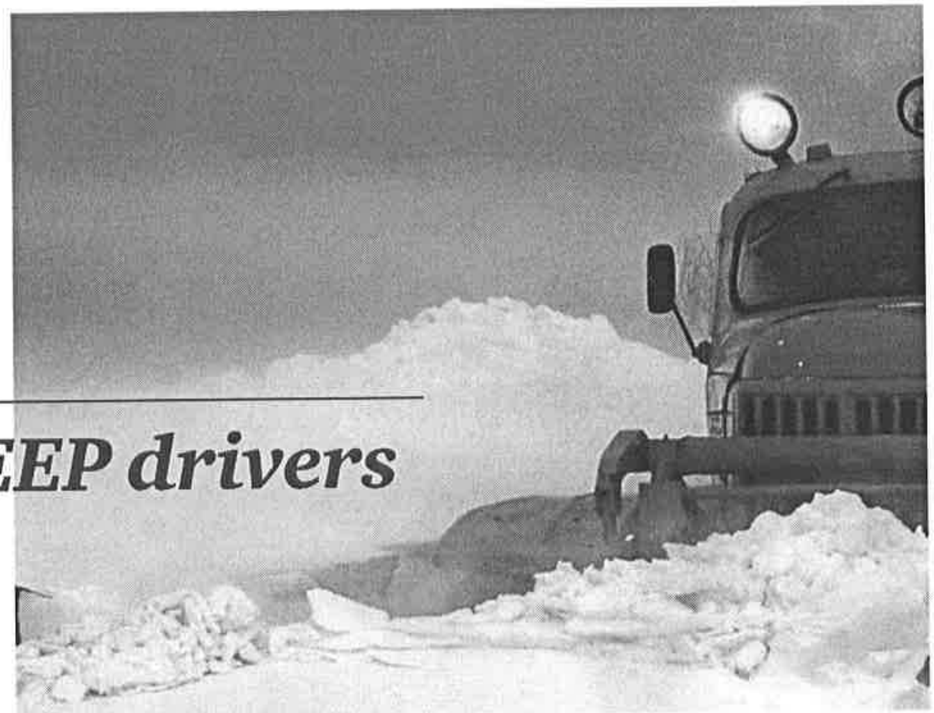
Figure 1: Scenario planning based business design

Factors & Drivers	Mega trends	Sectors	Scenarios	Industry impacts	Strategies	Design levers
What **Social, Technological, Environmental, Economic, and Political (STEEP) factors** and its component drivers impact the future?	What **mega trends** can be inferred from the STEEP factors and drivers?	How do these factors, drivers, and mega trends change by the three **insurance sectors** – personal lines, commercial lines, individual life, annuities and retirement?	What are the primary dimensions and **macro-scenarios** that can be mapped from the 'outside-in' analysis?	What are the key **industry impacts** that arise out of the three sectors of insurance?	Given their strategic intent and core capabilities, what **strategies** can develop and emerging market insurance players adopt to prepare for the future?	What **design levers** should companies use to execute their strategies to exploit the uncertain and fast changing future?

"Outside-in" Scenario Planning Analysis

"Inside-out" 3D Business Design Analysis

Source: PwC analysis

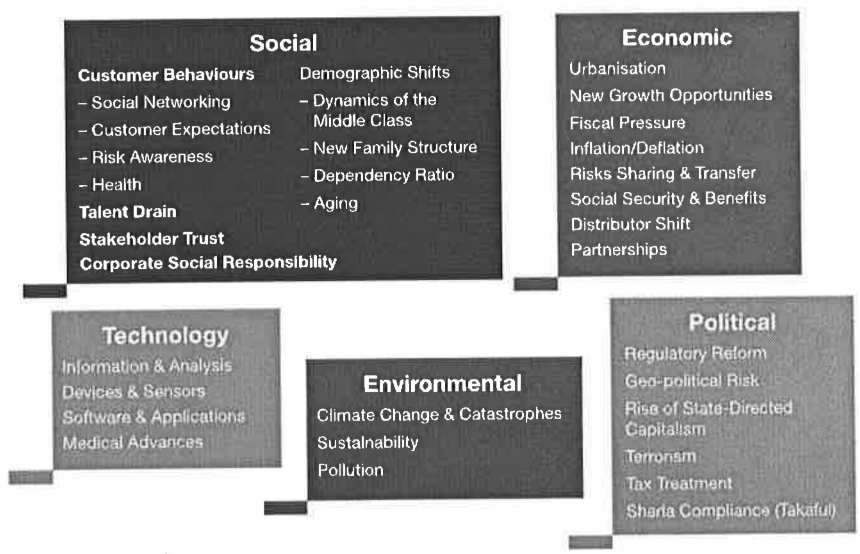


The key STEEP drivers

We have explored the five STEEP drivers to identify 32 factors that we believe will have an impact on the insurance industry (see Figure 2). STEEP factors have an impact on all sectors of insurance – personal, commercial and individual life, annuities and retirement – but not all changes will affect insurers positively. Economic growth, for example, in the short to medium term will be stronger in emerging economies. Forward-looking insurers in developed countries, however, can still grow in their local markets by exploiting socio-demographic and technological trends, while at the same time targeting emerging markets for growth. Similarly, insurers from emerging economies have an opportunity to reshape insurance products for their local markets while expanding on the global stage to build their technical expertise.

Although no one can predict exactly what STEEP changes will occur in the next decade, we believe five key mega-trends will influence the insurance sector. There are many more to consider (review the scenarios described in Figure 3) and with our research in place we are happy to walk you through them, but in this publication we will focus on:

Figure 2: STEEP drivers and factors



Source: PwC analysis

- **Social:** The balance of power is shifting towards customers.
- **Technological:** Advances in software and hardware that transform 'big data' into actionable insights.
- **Environmental:** The rise of more sophisticated risk models and risk transfer to address the increasing severity and frequency of catastrophic events.
- **Economic:** The rise of economic and political power in emerging markets.
- **Political:** Harmonisation, standardisation and globalisation of the insurance market.

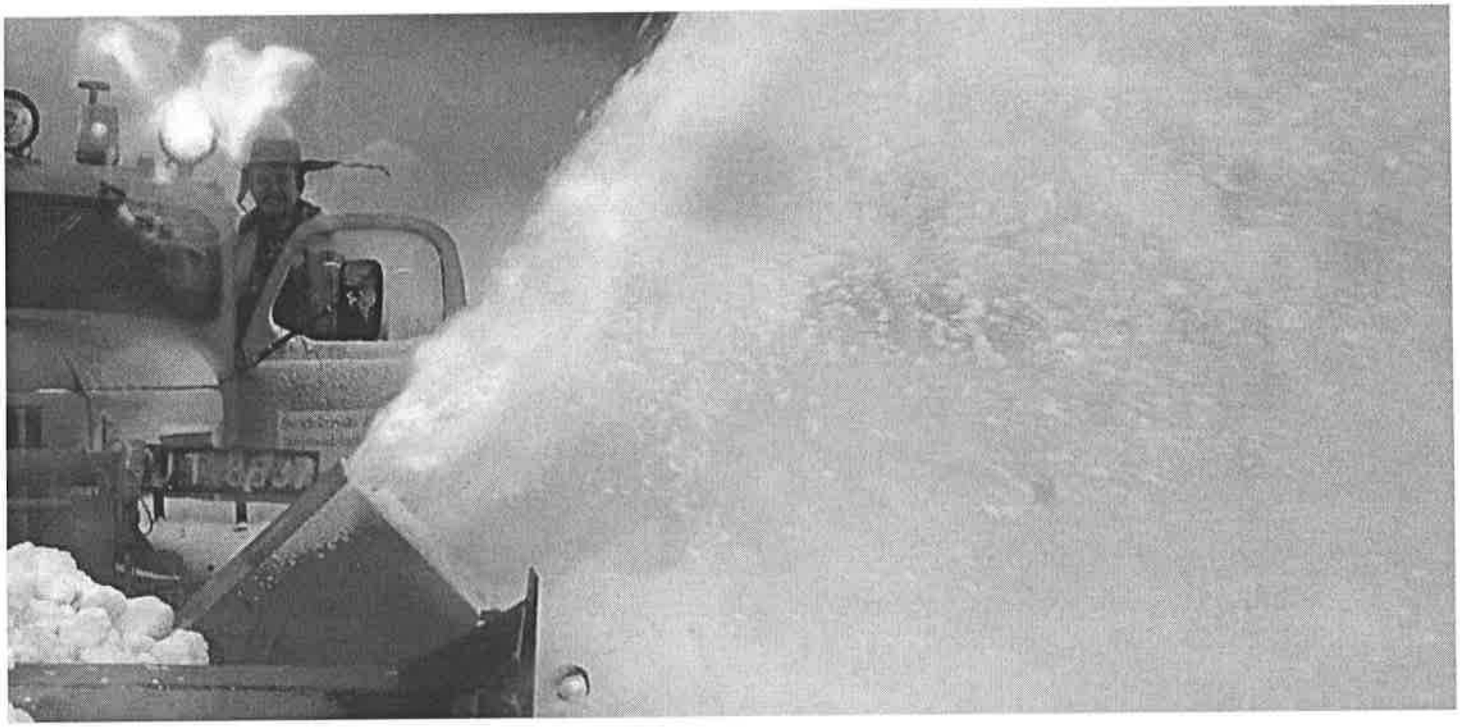


Figure 3: STEEP Drivers: The range of possible scenarios you face

Our detailed analysis of over 30 key STEEP drivers has enabled us to determine a range of possible macro-scenarios that the insurance industry faces. These macro-scenarios underpin the implications we have drawn for the future shape of the insurance sector.

	Regressive 1	Combination of factors 2	3	4	Progressive 5
Social	Customers predominantly seeking face-to-face interactions with intermediaries.	Distribution disruption in which multiple channels compete for customer interaction.	Distribution disruption where integrated multi-channel interaction is the norm.	Distribution destruction, where customers buy directly from carriers.	Distribution destruction, where self-forming groups of customers negotiate bulk purchases from carriers.
Technological	Insurers face increased data overload, quality and privacy issues, and cyber threats, resulting in a regression to 'gut-driven' decision-making.	Insurers continue to manage information overload and ever-increasing sophistication of analytical techniques that require ongoing investment to keep pace with competitors.	Sophisticated information analytics becomes the key determinant of competitive differentiation, which underwriting talent magnifies.	Sophisticated information analytics, new sources of information (from mobile sensors), and underwriting talent become the key determinant of competitive differentiation.	Sophisticated information analytics progresses to a point where no more useful information can be extracted and all key decision-making has been automated; competition shifts to prevention and productivity gains.
Environmental	With catastrophic events on the rise and insufficient data to accurately predict them, insurers will exit unprofitable areas.	Insurers will continue to rely on catastrophe models, but regulatory restrictions will prevent them from restructuring innovative risk transfer/sharing deals.	**Insurers will continue to rely on catastrophe models and sell innovative catastrophe insurance products through securitisation and reinsurance.**	Catastrophe modelling gets more sophisticated and uses advanced, early warning technologies to underwrite in specific, catastrophe-prone areas.	Advanced early warning technologies and new risk transfer/sharing mechanisms with public and private enterprises reduce human and property loss from catastrophic events.
Economic	The world moves from globalisation to regionalisation and insurers operate in and create products specific to narrow boundaries.	**Emerging market insurers grow in scale and importance, and limit opportunities for developed market insurers.**	As developed market insurers enter emerging markets, margins in these markets decline.	New emerging market insurers move into developed markets and become global businesses.	Truly global markets with products that are able to integrate multiple parts of the value chain, regardless of location.
Political	Governments in both developed and emerging markets enforce equally burdensome regulations on insurers decreasing their profitability.	Emerging markets erect more onerous regulations than developed markets' decreasing profitability and limiting control of developed market insurers.	Majority of regulations focused on banks, and insurers in developed and emerging markets are able to get away with minimal regulatory changes to pricing, coverage, rates and reserves.	Emerging markets and developed markets enact less burdensome regulations and emerging markets relax their regulations to ease the entry and control of developed market insurers into emerging markets.	The regulatory climate improves with greater harmonisation across countries (and within states in large countries). Regulatory harmonisation leads to standardisation across products and practices.

Source: PwC analysis

Social: The balance of power is shifting towards customers

New and ongoing social trends will shake up traditional business patterns in the insurance industry, resulting in an increase in consumer power:

Customer expectations: Customers (consumers and businesses) are increasingly demanding simplicity, transparency and speed in their transactions with businesses, including insurance agents/advisers and carriers. The relentless march of online and mobile technology is continuing to fuel this change in customer expectations.

In a recent survey of US consumers, more than 32% of all respondents – and 50% of those aged 18 to 25 – said they prefer to work directly with insurance carriers.[1] This 'push' towards direct interaction will continue across both personal lines and individual life insurance sectors. In addition, the online world is also becoming increasingly mobile as smartphone and tablet use increases and fuels the demand for localised information, available anytime, anywhere. By 2014, for example, the number of mobile internet users is expected to overtake desktop internet users.[2]

These changes will substantially impact the insurance sector:

- More and more insurance will be 'bought' by customers as opposed to being 'sold' by agents destroying the age old wisdom of 'Insurance is sold and not bought'. This fundamental shift will force insurers and agents to re-examine their roles in the insurance value chain and become more relevant to the end-customer (consumer or business).
- Customer expectations of simplicity and transparency will foster innovations in product/service design and delivery. Leading insurers will get better at targeting customers and customising product and service attributes to meet their specific needs, amassing greater customer surplus.
- Mobility and speed of service demanded by customers will translate into investments in mobile and interactive technologies for multimedia content creation and distribution as well as transactional capabilities across multiple digital platforms.

Social networks: The rapid adoption and fast evolution of social networks will continue to empower both consumers and businesses to communicate more transparently and to harness the buying power of virtual communities. The growth of social networking – one of the fastest ever global adoptions – will help shift the balance of power towards customers. In just six years since its launch, for example, Facebook has attracted over 800 million users.[3] As consumers become even more comfortable with social networks several scenarios are likely to develop:

- People exchange more personal information and start building networks of trusted friends, family and acquaintances, shifting the balance of trust from insurance agents and advisers to online communities.
- Online social networks wielding substantial purchasing power become new group insurance channels, benefiting from information-driven online intermediaries.
- Eventually, online social networks become pooling mechanisms for self-insurance, changing the role of insurers at a primary level from product manufacturers to administration service providers.

1 Source: Coverhound: Car Insurance shoppers still prefer to deal with local agents over direct carriers, January 2011
2 Source: mashable.com: mobile by the numbers (infographic), March 2011
3 Source: Facebook statistics, November 2011

From distribution dominance to distribution destruction

Historically, the insurance sector has been dominated by intermediaries who have played the role of understanding consumer and business needs, and then matching and tailoring insurance products and solutions to their needs. Internet, mobility and social networking have changed the game over the past decade and have created a new generation of customers who demand simplicity, speed and convenience in their interactions. These trends will accelerate, leading to a situation where customers will be more willing to buy 'direct' using their online and offline 'trust' network of friends and family to guide their choice. This will result in a fundamental redefinition of the role of advice and the disappearance of distributors as a sales channel.

- 45% expect 'distribution destruction' where customers buy direct and even form groups to negotiate bulk purchases direct.

Source: PwC Research from more than 150 C-suite executives polled at a presentation of the Future of Insurance to the International Insurance Society (IIS), June 2011.

Technological: Advances in software and hardware are transforming 'big data' into actionable insights

As the insurance industry reaps productivity gains from the most recent wave of automation, new technologies are significantly enhancing operational efficiencies, increasing revenue opportunities and improving the customer experience. The important new technological developments for the insurance industry are:

- The growth in smartphones and tablets, coupled with cloud computing, which provide constant access to the internet.
- The explosion of computing power and storage, enabling the accumulation and analysis of extremely large amounts of data.
- The growth in active sensors and devices connected to the internet.

Big data: The growth of internet connected devices and sensors, which are projected to reach 50 billion by 2020,[4] will have a significant impact on the availability of real-time information – a trend often referred to as 'big data'. Insurers who can exploit this information for better pricing, underwriting and loss control will have a distinct competitive advantage over their peers.

To harness the 'big data' trend, global investment in advanced analytical techniques is increasing in order to develop the capabilities to process large volumes of unstructured and multimedia data, such as continuous real-time video, life blogging and social chatter. These advances will lead to software – and eventually hardware – that can translate 'big data' into actionable insights.

Advances in Artificial Intelligence techniques, such as machine learning, natural language understanding and intelligent decision-making will allow insurers to advance from using technology for transaction processing to decision-making. Today, analytical techniques are used for making ad hoc decisions using structured data.

By 2020, the use of unstructured data (e.g. social media, devices, video and audio) will complement structured data, allowing insurers to make strategic forward-looking decisions.

From a reactive to a preventative business model: Commercial insurers are already using connected devices and sensors to develop risk and loss management and improve productivity, but we also envision life and health insurers using them as well.

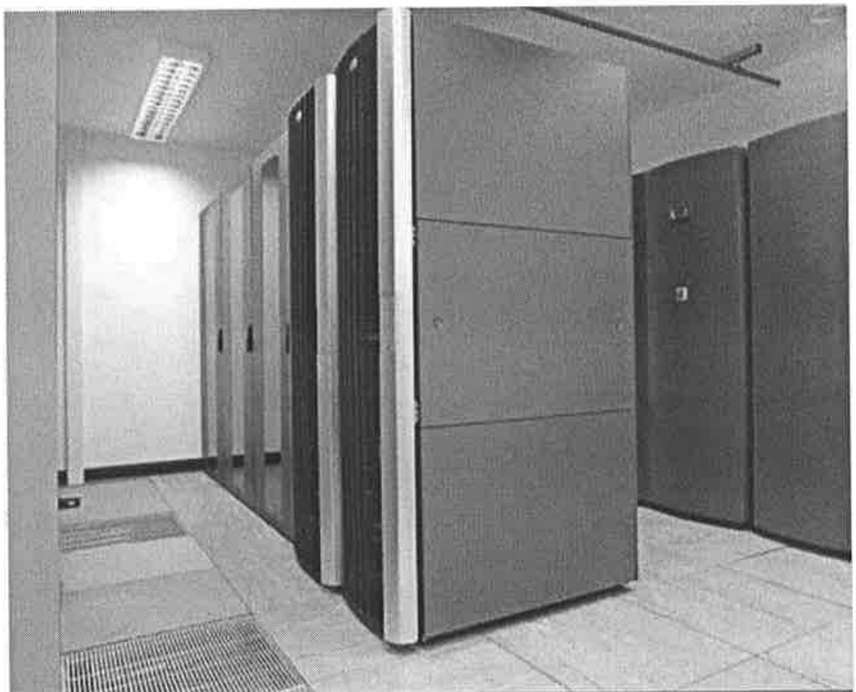
By 2020, a number of biotechnologies will be available at the nanoscale, providing the ability to embed devices and sensors unobtrusively within the human body. The nanotechnology drug delivery market is expected to grow at a CAGR of 21.7% between 2009 and 2014, and reach almost $16bn by 2014.[5] Such nanotechnologies have the potential to dramatically improve health outcomes through enhanced monitoring and preventive control of chronic disease.

4 Source: CISCO, The internet of things: How the next evolution of the internet is changing everything, April 2011

5 Source: Companies and Markets, Nanotechnology in Healthcare: Market outlook for applications, tools and materials, January 2010

The medical service and treatment model is evolving towards the customisation of healthcare; the resultant decrease in morbidity and mortality will have a profound impact on life and health insurers. Consumers will eventually use personalised medicine to create highly customised healthcare solutions that actively change the body's biochemistry in response to risks and conditions that are unique to each person. We anticipate that these medical advances will flatten the cost curve as mortality and morbidity rates dramatically improve. Some of these advances can also reduce litigation costs as medical product manufacturers can provide detailed evidence on the efficacy of their drugs.

Commercial insurers have always focused on loss control and risk management, but that trend will deepen and expand into other lines of insurance. Personal and life carriers will be able to move from passively identifying and pricing risk and reactively paying claims to proactively using 'big data' and actionable insights to reduce losses and better manage risk. For life and health insurers as well as annuity and retirement income providers, monitoring devices could significantly extend life expectancies and increase the number of years of active retirement life.



From a structured data/tactical decision-making/reactive business model to an unstructured data/strategic decision-making/preventive model

Historically, the insurance sector has used, primarily, internal data in a structured format to make tactical and operational decisions around which customers to target, how to price the risk, how to estimate the losses, etc. However, in the next decade the industry will increasingly use large amounts of real-time sensor data, unstructured data from social networks, and multimedia data such as text, voice and video. As sophisticated artificial intelligence techniques evolve, insurers will start using this unstructured data for forward-looking strategic decisions such as, which product or solution is most suited for a client given their current and future situation, which emerging countries to enter as well as when and how proactively to manage customer experience to enhance retention of the most profitable customers. Insurers who are able to use real-time 'big data' and advanced forward-looking simulation techniques will establish a significant competitive advantage.

- In a recent survey, 49% expect new sources and techniques in the use of data analytics to be the key competitive differentiator.

Source: PwC Research from more than 150 C-suite executives polled at a presentation of the Future of Insurance to the International Insurance Society (IIS), June 2011.

Environmental: The severity and frequency of catastrophic events is increasing

The severity and frequency of catastrophic events, both natural and man-made, have been increasing over the past 20 years. Between 1990 and 2009, hurricanes and tropical storms accounted for 45.2% of total catastrophe losses,[6] and the rate and intensity of these storms is predicted to increase with global climate change. A large portion of claims' payouts result from business interruption coverage losses – in the Chilean earthquake, for example, over 50% of claims were filed for business interruptions and extra expenses.[7]

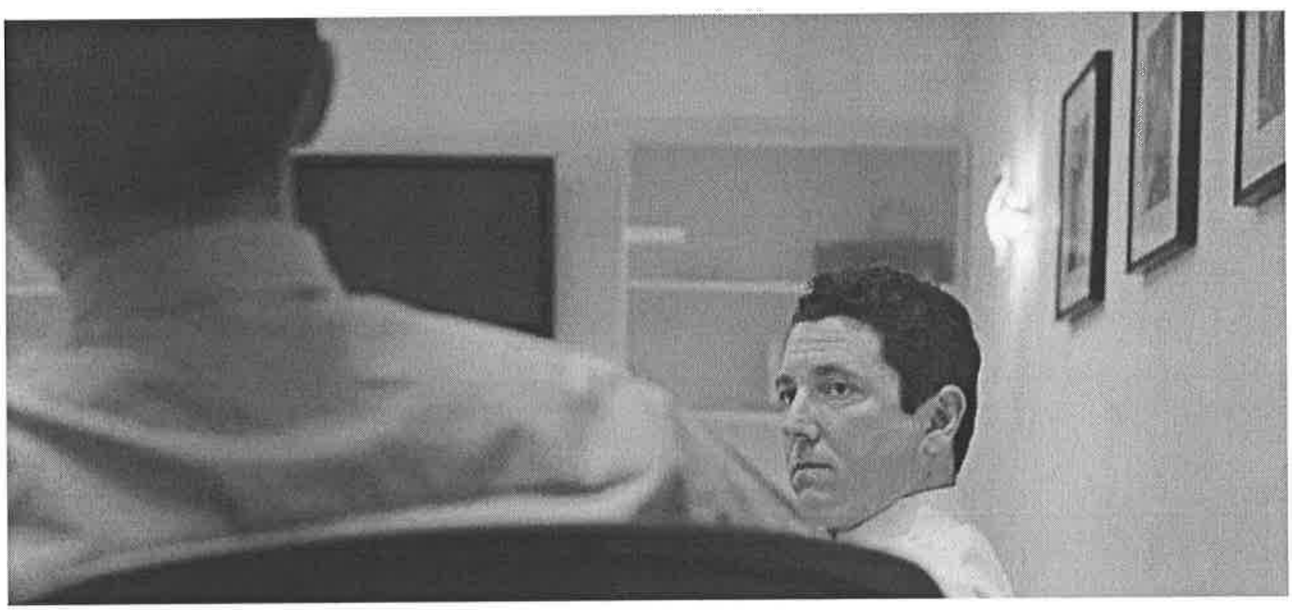
In addition to catastrophic events, insurers must also consider man-made degradation of the environment. Increasing energy consumption and associated atmospheric pollution will directly impact carriers' risk exposure. The US Energy Information Administration, for example, predicts world energy consumption will grow by 49% between 2007 and 2035.[8] With continued fossil fuel use, pollution will remain a significant health issue, threatening the well-being of populations in both developed and developing countries. Life and health insurers will need to closely monitor trends in atmospheric pollution in order to acurately assess risk in different regions.

Environmental measures will help mitigate the most serious consequences. Renewable energy sources are projected to account for 23% of electricity by 2035.[9] Increased consumer investment in sustainable solutions (e.g. solar panels) will gradually create new modelling and pricing risks for Property & Casualty (P&C) insurers.

Managing these types of risks will require insurers to be more sophisticated in their risk modelling and innovative in structuring risk-sharing and risk transfer deals. Catastrophe modelling will become more sophisticated and use advanced, early warning technologies to underwrite in specific, catastrophe-prone areas. Insurers who fail to keep pace with this increasing sophistication might be forced to exit markets in certain coverage areas, such as those prone to flooding or forest fire.

Increased severity and frequency of catastrophic events overwhelming insurers vs technology and risk transfer easing the pain

Historically, the insurance sector has been good at developing catastrophic models that capture known high severity/low frequency events (e.g. earthquakes, tsunamis, etc). However, most of these models perform poorly when it comes to unknown 'Black Swan' events. Over the next decade the insurance sector could be overwhelmed with uncorrelated catastrophic events reducing capacity and raising prices. Alternatively, new sensing and monitoring technology, together with risk transfer mechanisms, could cushion insurers and reinsurers against abnormal losses.



6 Source: Insurance Matters: Information for policymakers, Catastrophes: Insurance Issues, June 2011
7 Source: Insuring Florida, Catastrophes: Insurance Issues, October 2011
8 Source: US Energy Information Administration, World energy use projected to grow 49 percent between 2007 and 2035; Rapid growth projected for renewables, but fossil fuels continue to provide most of the world's energy under current policies, Press Release May 2010
9 Source: US Energy Information Administration, International Energy Outlook, September 2011

Economic: The rise of emerging market economic and political power

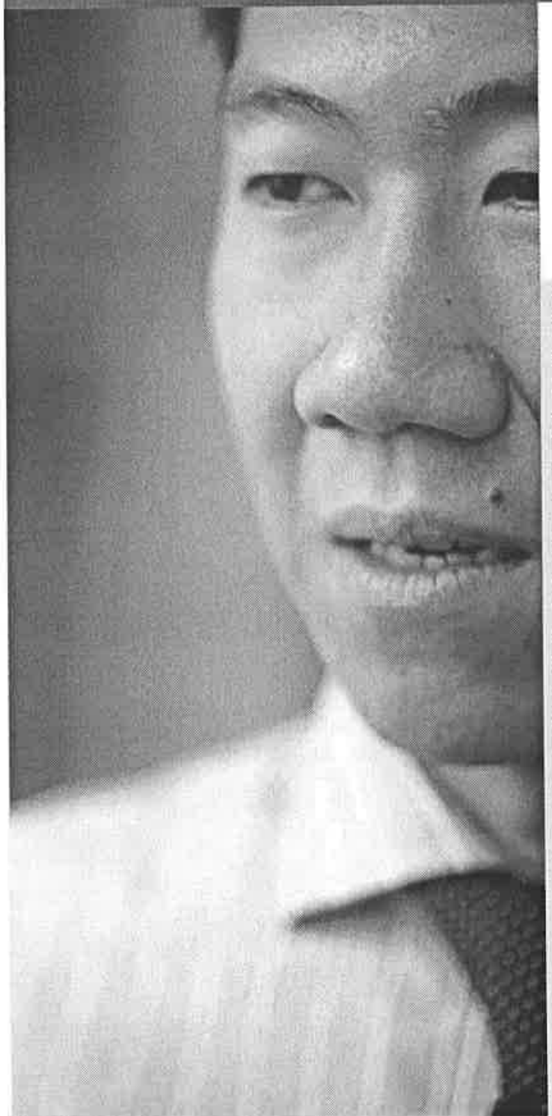
The increasing attractiveness of the emerging markets, combined with uncertain growth in the developed world and stricter regulatory guidelines will make carriers re-evaluate their strategic goals towards developing countries.

The E6 countries' (China, India, Brazil, Russia, Indonesia and Mexico) proportion of global GDP has been increasing over the past 20 years, and the liquidity and debt crunch precipitated by the financial crisis of 2008 continues to affect developed economies far more than emerging ones. It is estimated that the E6 will contribute 47% of Global GDP growth between 2006 and 2020, while the G6 will contribute less than 24% during the same period (Figure 4).[10]

A number of factors are contributing to the ongoing shift from a world dominated by developed markets to a world in which the majority of growth is in emerging markets:

- In the developed world, the old outnumber the young. In emerging markets (except China) the working age population will continue to outnumber the dependent population, and thereby result in more productive growth.
- The rise of the middle class in emerging markets is fuelling increased consumption, which is leading to impressive small business growth.
- Government infrastructure investment, population growth, new businesses and wealth creation are driving growth in construction, land development, energy and transportation sectors, all of which are creating a greater need for insurance.

10 Source: Economic Intelligence Unit, Foresight 2020



The rise of economic influence and power of emerging market countries and emerging market insurers

Over the past couple of decades the world's economies have become more interdependent and this trend is likely to continue. However, the power and influence of the US, Europe and other OECD nations will wane as the emerging markets continue to grow as well as become the engine for global growth. As consumption in these countries increases, the insurance market will grow, resulting in big opportunities for emerging market insurers. The developed market slowdown, due to the financial crisis, will accelerate this shift in power towards emerging market economies and emerging market insurers. In a recent survey conducted by PwC:

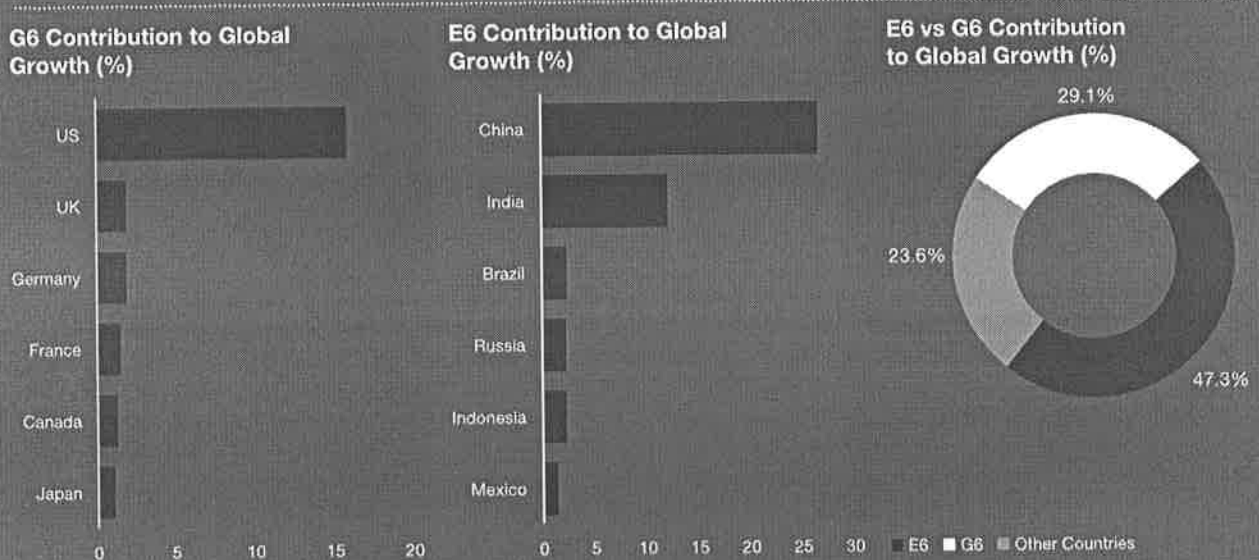
- 30% believe new emerging market insurers will move into the developed world to become global insurers.
- 28% foresee truly global markets.

Source: PwC Research from more than 150 C-suite executives polled at a presentation of the Future of Insurance to the International Insurance Society (IIS), June 2011.

The uneven distribution of economic growth between the developed and emerging markets creates different scenarios for insurance industry competitive dynamics:

- The insurance industry as a whole could become more globalised as countries harmonise regulations, standardise practices and distribute products across borders (see 'Political' on page 10). This could lead to greater market share for global insurers, as well as economies of scale and scope that drive the globalisation of the insurance value chain.
- Conversely, twin-track growth and the loss of the developed world's authority in the wake of the financial crisis could result in greater protectionism by countries or regions.
- In-between these two extremes, developed market insurers could increase their attempts to find growth in emerging markets, and or emerging market players could expand into developed markets for know-how and talent.

Figure 4: E6 vs. G6 Contribution to global growth (2006–2020)



Source: Economic Intelligence Unit, Foresight 2020

The developed market slowdown, due to the financial crisis, will accelerate this shift in power towards emerging market economies and emerging market insurers.

Political: Harmonisation, standardisation and globalisation of the insurance market

We see a range of potential outcomes from a regulatory perspective. The financial crisis has enhanced communication and dialogue between and among the US, EU and emerging market regulators:

- If regulators are successful at negotiating and harmonising global insurance regulations, this could lead to greater standardisation of products and policies, and promote more globalisation of the insurance value chain.
- On the other hand, regulators could continue to develop new but different (and potentially onerous) regulations in each market.
- In-between these two extremes, it is possible that emerging markets will prevent developed market players from entering their markets or put limits on their activities. (An alternative intermediate scenario is that emerging markets encourage developed market entry by removing restrictions and easing regulatory burdens.)

Outside the regulatory arena there are several additional political trends for insurers to consider:

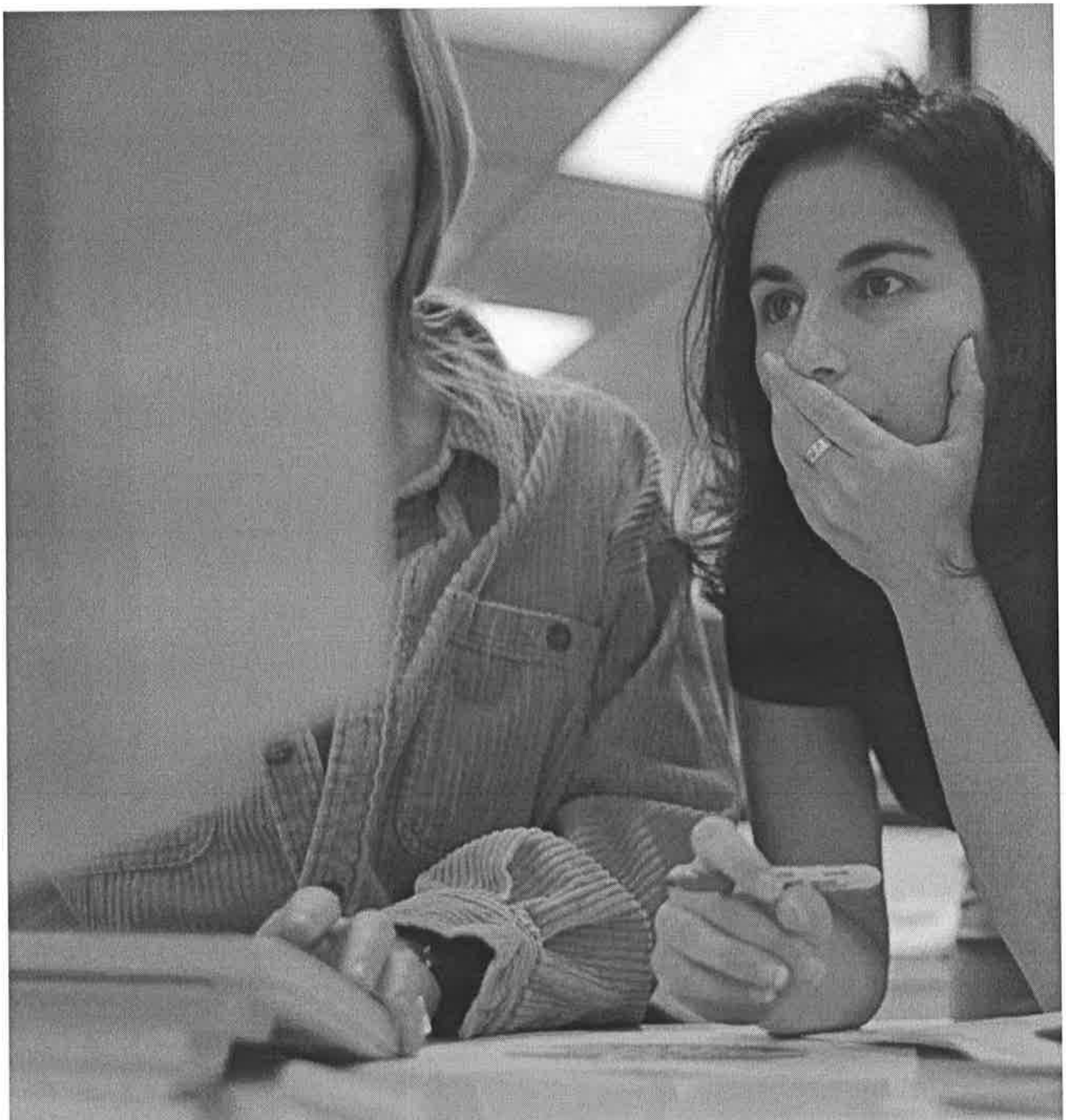
Pressure on the solvency of social security and welfare programmes throughout the world will increase because of rising dependency ratios. Dependency ratios (defined as the ratio of the number of persons aged under 18 or over 64 to the number of persons between these ages) are expected to increase by an average of 14% in the G6 between 2000 and 2025.[11] Using current projections, the US Social Security Trust Fund will be depleted in 2037 and Social Security will be able to pay only 78 cents in the dollar.[12]

Consumers lacking faith in the solvency of social security programmes will begin to focus on providing their own savings for retirement, as governments pare back benefits. This will create new opportunities for life and annuity insurers, although governments under financial pressure are likely to seek ways to reduce spending while increasing tax revenue. The preferential tax treatment of life, annuity and retirement policies may be viewed as an easy target for revenue generation. Insurers will need to adapt nimbly in order to weather these changes.

Terrorism. Over the past 30 years, there has been an increase in terrorist attacks around the world. Terrorists currently attack global supply chains once every four days on average.[13] Carriers will have increased exposure as the frequency of major attacks increases. In addition, terrorist attacks often impact multiple product lines (e.g. commercial property, business interruption, workers compensation, life and benefits), which are often modelled independently. As a consequence, the potential losses from so-called 'uncorrelated' risk factors could be large, requiring substantial industrywide or state-provided capital to insure losses beyond a certain level. Further detailed modelling is required to understand the capacity requirements for terrorism coverage.

Geopolitical instability. Resource scarcity around the world is magnifying the risks of geopolitical instability, as evidenced by the current political upheaval in the oil-producing nations of the Middle East and North Africa, or the 'Arab Spring'. This has caused resource-consuming nations to reassess their energy policies. We anticipate that the potential for fewer despotic regimes in the Middle East and technological solutions to resource scarcity will lower geopolitical risk over the next ten years.

11 Source: Alliance for Health & the Future, The Dependency Ratio, Issue Brief Vol 2, Number 1
12 Source: Centre for Retirement Research at Boston College, The Social Security Fix-it Book
13 Source: Terrorists attack global supply chains every four days. SupplyChain Digital, April 2011



Harmonisation and standardisation of insurance regulation, products and practices

Over the past couple of decades the world's economies have become more interdependent and this trend is likely to continue. However, the power and influence of the US, Europe and other OECD nations will wane as the emerging markets continue to grow as well as become the engine for global growth. As consumption in these countries increases, the insurance market will grow, resulting in big opportunities for emerging market insurers. The developed market slowdown, due to the financial crisis, will accelerate this shift in power towards emerging market economies and emerging market insurers. In a recent survey conducted by PwC:

- 30% believe new emerging market insurers will move into the developed world to become global insurers.
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Source: PwC Research from more than 150 C-suite executives polled at a presentation of the Future of Insurance to the International Insurance Society (IIS), June 2011.

Implications for the future of your business

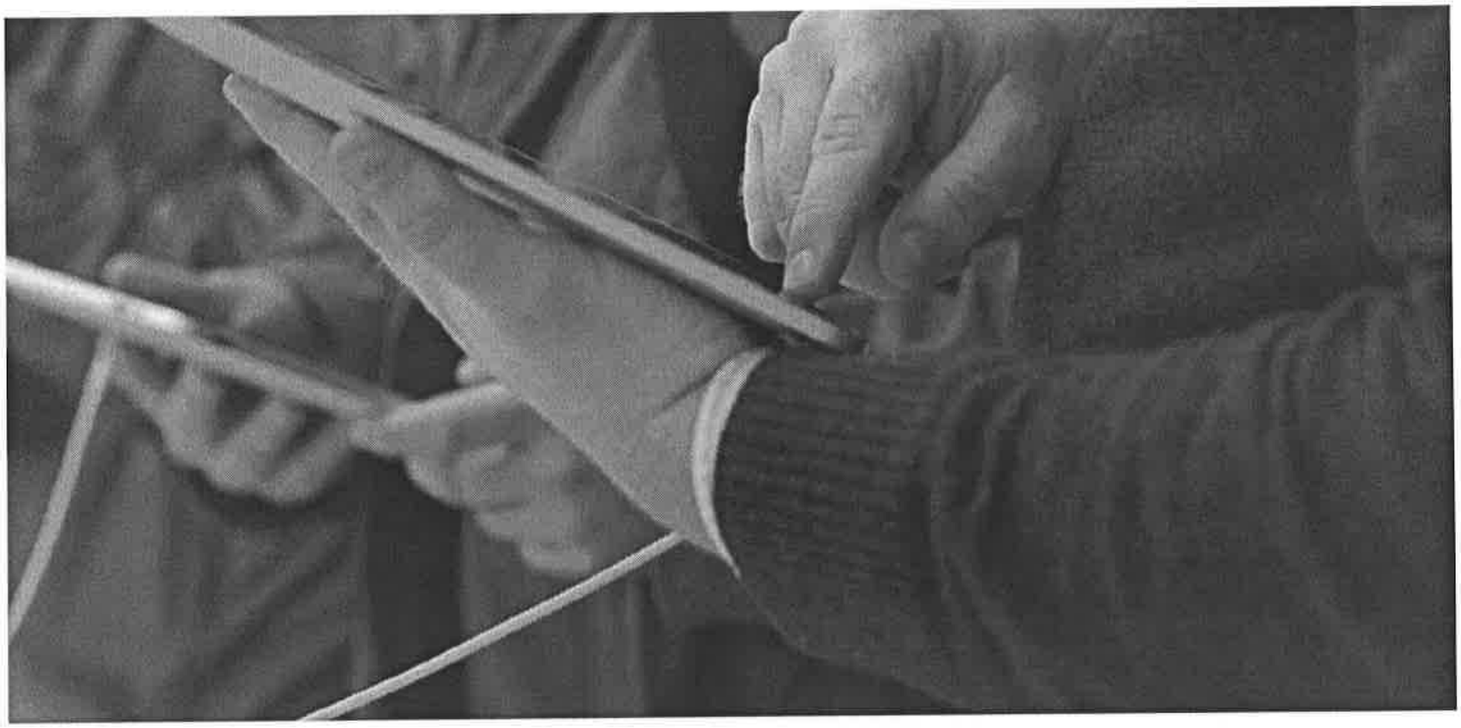
We have analysed the STEEP factors and drivers for each of the three insurance industry sectors. While some drivers, such as direct purchase, are common, their impact could be greater in one sector (e.g. personal lines) than in others (e.g. commercial lines). Also, some sectors will have additional drivers, such as health advances and their impact on life and disability insurance.

Personal lines

We believe personal lines insurance will change in four fundamental ways:

- **Greater commoditisation.** Price transparency, dis-intermediated direct purchase and virtual social community-led bulk purchase will all lead to greater commoditisation of personal lines insurance. In the immediate term, insurers in some emerging and underdeveloped markets will be able to generate good margins. As personal lines insurance becomes more global over time, however, these margins will vanish in a price-based, competitive world.
- **Decreasing profitability.** The increased number of megacities being built in areas prone to natural disaster could result in catastrophic losses. With no opportunities for diversification, this could result in highly volatile earnings and decreasing profitability for insurers.
- **Automated underwriting.** As personal lines insurers expand globally, ageing underwriting resources in the developed world and lack of underwriting skills in emerging markets will lead to severe talent shortage. However, insurers who are able to recruit or retain top underwriters and use their knowledge to build sophisticated predictive modelling should be able to gain greater market share. Automated underwriting, more standard in the developed world, will be increasingly adopted in the emerging markets as the globalisation of the personal lines sector continues.
- **Greater loss control.** In the immediate term, insurers will use advances in telematics primarily to price mileage-based insurance. But, in the medium term, they will use telematics to proactively control losses and manage risk, which should substantially enhance operating profitability. Over time, this competitive advantage will disappear as automotive safety features and advanced analytics become commonplace.

Projecting future scenarios on a global scale with countries growing at different rates, insurance sectors at different stages of maturity, and insurance carriers with different strategies and capabilities is a challenging task. Rather than detail all different combinations of scenarios coming out of the 32 drivers, we highlight here some key scenarios from the perspective of illustrative insurance carriers and their strategies. Scenario A highlights the story of a hypothetical personal lines insurer and how it 'Creates its own future' by expanding globally.



Scenario A

In March 2012, the CEO of PL Insurer came out of a three-day strategy session determined to shape the company's future. PL Insurer, operating in more than 25 countries across the globe, was struggling to cope with tectonic social changes in consumer attitudes and behaviours. An increasing number of customers were migrating online, while use of mobile technology and social networks (including in the emerging market countries) was increasing rapidly. The agency-based distribution model that the company employed in 18 out of the 25 countries was being challenged by the adoption of innovative usage-based business models and telematics by the competition, as well as by increased capital requirements and regulatory oversight across the world. The CEO was determined to reinvigorate his global growth and innovation strategy, redefine the experience that consumers and agents shared with PL Insurer, and to build an insight-driven business model that would revolutionise decision-making across the organisation.

On 3 April 2020, as the CEO of PL Insurer is flying back to New York from Shanghai, he reflects on the past eight years since the pivotal historic meeting with his senior management in 2012. In that intervening period PL Insurer has become the largest global P&C insurer, now operating in 150 countries, with a combined ratio that is the envy of the industry. Over the past five years, profitability has been steadily climbing and the company has a war chest of cash to acquire companies. The regional distribution and operational model adopted by PL Insurer to serve its six global regions acts as a hub to share best practices, increase efficiency where possible through automation and centralisation as well as enhance effectiveness by devolving decision-making to the regional or country level. The SocInsurance global subsidiary is the fastest growing subsidiary of PL Insurer, offering personal insurance to social networking affinity groups. The advanced analytical and underwriting capability that SocInsurance has built allows it to select targeted segments and tailor its products, based on their social affinity. The patented interpretive underwriting engine offers PL Insurer a distinct competitive advantage over its competition, which will continue for at least three more years. The CEO is pleased that the steps he took to 'Create the Future' in 2012 have paid off so handsomely.

Commercial lines

We expect commercial lines to experience the following significant changes over the next decade:

- **Virtual business affinity groups.** Social networking among small business owners will create virtual business affinity groups that pool their risks and retain greater predictable layers of risk. Greater availability of information and increased price transparency will facilitate this trend.
- **Automated underwriting.** Current trends in automation of quoting and underwriting functions for commercial insurance will continue as insurers try to match underwriting capacity with the complexity of application inflow. The talent premium, especially underwriting talent, will have a much greater impact on commercial insurance than on personal insurance.
- **Business model transformation.** Real-time data from sensors and devices will continue to transform the commercial insurance business model. Commercial insurance will increasingly focus on providing standardised products and value-added services that involve working with the clients to proactively avoid or reduce losses and manage risks. In addition, risks are becoming more complex, offering the opportunity to harness improved data analytics to develop new risk transfer markets.

Similar to the scenario we discussed earlier, the following Scenario B highlights the story of a hypothetical regional commercial lines insurer and its success in adopting a 'Fast Follower', 'niche player' strategy.

Scenario B

RegCo Insurer, is a regional commercial insurer, focused on commercial lines insurance. In 2012, large global commercial insurers, capable of serving clients globally as well as regionally, were challenging RegCo's business. These competitors were operating at a combined ratio that was hard for a regional player like RegCo to match. RegCo can offer more customised risk management solutions to its commercial clients, but at a cost that adversely impacts its combined ratio, making it less profitable. As RegCo started planning for its future, it decided to reinvent itself by following other regional commercial insurers and move from being a product manufacturer to a risk management solution provider.

By 2020, RegCo is flourishing and has become one of the top 20 risk management solution providers. Starting in 2012, RegCo progressively withdrew from the product manufacturing business and instead partnered with brokers, reinsurance carriers and commercial lines carriers, to transfer its customers' risks. RegCo built a leading risk management solution that utilised embedded sensors and devices to monitor commercial risks in real-time and thereby control losses. Adopting a fee-based solution and value-share business model, RegCo was able to demonstrate the huge reductions in losses its solutions could provide and took a share of those savings. Its 'fast follower' strategy adopted in 2012 allowed it to flourish in the risk management space while some of its competitors were acquired, or went bankrupt.

Individual life, annuities and retirement

Environmental factors, urbanisation and changing customer behaviours will all greatly affect the life, annuities and retirement sectors. These sectors will also experience significant changes in response to global demographic shifts over the next decade:

- **New products for seniors.** An ageing population in most developed countries will result in new growth opportunities in drawdown or retirement income products, long-term care products and longevity insurance. While the growth opportunities for managing retirement portfolios before and after retirement is huge, insurers will face intense competition from other financial service providers, including banks, wealth managers and asset managers.
- **Insurers step onto government turf.** The increasing dependency ratio in most developed countries (and China) will increasingly strain government support for the elderly and sick, leading to prolonged employment and/or a reduction in the standard of living. This could open up the opportunity for insurers to form public and/or private partnerships to offer value-added solutions in response to a political challenge.
- **Better risk management.** Greater availability of medical and behavioural data, along with personalised medicine, will continue to drive greater sophistication in, and automation of, underwriting and provide the opportunity to better manage risk and to expand the boundaries of insurability.
- **Tailored products.** For group benefits, the responsibility for protection and retirement savings will continue to shift towards the individual. This will result in increasing voluntary coverage, as well as worksite marketing.

Current trends in automation of quoting and underwriting functions for commercial insurance will continue as insurers try to match underwriting capacity with the complexity of application inflow.

Scenario C

LifeCo is a global life, annuities and retirement (LAR) carrier operating in the US, Europe and Australia. In 2012, the low interest rate environment had decreased profitability and LifeCo's legacy technology made it difficult to adapt to the changing needs of its customers. LifeCo's executive team was faced with customers' ongoing desire for simplicity, transparency and speed as well as solutions to help them lead healthier lifestyles. Other challenges included data aggregation and value extraction, staying ahead of medical advances and developing products to accommodate longer lifespans and working years. Gaining approval from the Board, LifeCo's CEO embarked on a strategy to provide an industry-leading customer experience, develop an organisation focused on business intelligence and create products and partnerships to reinvigorate LifeCo's growth across the globe.

Preparing for 2020's first board meeting, LifeCo's CEO is proud of what his executive team has accomplished. The strategy he implemented has made LifeCo profitable again, with one of the lowest operating expense ratios in the industry for the past three years. By developing a personalised customer portal while providing binding quotes in a matter of minutes, LifeCo has become the first choice among agents and consumers. Hiring an experienced business intelligence (BI) leader was one of the best decisions the CEO made. Reporting directly to the CEO, the BI leader enabled the consistent flow of insightful, fact-based information, helping the executive team make the right decisions, faster. Utilising this information and partnering with a medical device company providing biotechnology to monitor health, LifeCo developed low-priced, consumer-specific, localised products offering discounts in later years for consumers living healthy lifestyles. LifeCo developed novel long-term care products for the increasing elderly population and also entered the Takaful market as it expanded into the Middle East. As LifeCo's product breadth grew, the company expanded its distribution channels by working with local carriers and brokers in other countries to expand its global footprint. As the CEO adds the finishing touches to his board presentation, he realises that LifeCo has become a true innovator in the industry and he looks forward to conveying that story to the board.

Some changes affect everyone

In addition to these sector specific factors, all insurers will be effected by the shift towards a global interconnected model, automated and assisted decision-making, based on data and insights and changes in the industry cost structure:

Globalisation and interconnectivity of risks. Apart from reinsurers and some commercial line insurers, most others have typically operated at the local or national level, and have been primarily involved in measuring risk exposures and determining the premium that they need to charge customers to insure their risk. However, given the scale of change implied by the STEEP trends, we believe that more insurers will be forced to think globally. In the future, insurers will be more involved in deciding which geographies, products, customer segments and channels will offer their desired level of growth, profitability and risk appetite.

Automated and assisted decision-making. Following the automation of transactional systems and the automation of interactions with customers, we are entering a new era of automating decision-making. Extensive internal and external data, as well as new artificial intelligence-based techniques will expand the scope of assisted and automated decision-making of insurers across a variety of functions. These include identification of markets/segments to enter or grow, customer segmentation, risk selection, advice engines that assist agents/advisers or end-consumers, claims triaging, and proactive preventive loss prevention and management.

Changing cost structures. Insurers who fully exploit the potential offered by the internet to transform their cost structures will be able to scale themselves exponentially and leverage their people, operations and technology infrastructure globally:

- Insurance distribution has traditionally relied on a commission-based variable cost model for sales; the route to increased sales was to 'put more feet on the street'. With increasing investment in direct online channels, cost structures are moving towards a larger upfront fixed cost, but a lower ongoing variable cost (provided you achieve the desired scale).
- Over the past two decades, insurers have invested heavily in operations and technology, incurring largely fixed costs to build IT infrastructures capable of dealing with their estimated customer base. Now, as more and more applications migrate to the 'cloud', information is available anywhere, anytime and at very little cost. If you have more standardised and streamlined processes you can use the cloud to move to a low variable transaction cost model that scales exponentially.
- With the right talent and proper use of information and analytics in underwriting, a greater number of transactions can be automated. This will allow the application of superior underwriting insight to a greater number of your transactions, helping overcome the looming talent gap as the current generation of underwriters approach retirement age.