News release

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PwC survey: Global insurance industry views technology modernization and cyber as greatest threats

Hamilton, Bermuda – The urgent need for business and technology modernisation poses the greatest threat to the global insurance industry, according to **The Insurance Banana Skins** report, published by the **Centre for the Study of Financial Innovation (CSFI)** in association with **PwC**. At the heart of responses was the view that many sector players are weighed down by legacy business models and IT infrastructure that are poorly equipped to handle the changing demands of the industry.

The global report follows on from previous surveys issued biennially since 2007. This year's analysis was based on 927 responses from 53 territories, including **32 Bermuda** respondents.

Threats posed by **cybercrime** were judged to be the *second* biggest Banana Skin. Cyber concerns from past surveys have intensified. The insurance industry – an enticing target because of the volume of valuable data it holds - faces a barrage of attacks from criminals and state-actors, many of which are extremely sophisticated, the report suggests.

Cyber risk, both as a security issue and an underwriting risk, is the top concern of the reinsurance sector, as in the previous survey. However **climate change** came No. 2, marking a dramatic new entry to the ranking.

The risk that inadequate response to change management will damage insurers continues to be seen as urgent, taking third spot on this year's list. Demand for these changes to be implemented is being driven by technologies such as artificial intelligence; the internet of things which is overhauling insurance markets and radically different customer expectations.

Significantly, the overall tone of the responses this year is the most negative we have seen since we began the series in 2007. This is largely due to the scale of the challenges facing the industry through technological and structural change, and concern about the industry's ability to manage them successfully. The results should also be seen against a background of growing economic uncertainty around the world, and heavier regulation.

Despite the drop in sentiment, the overall view on insurers' ability to handle these risks is that they are better prepared than ever, with greater confidence in their ability to navigate the potential stumbling blocks.

Arthur Wightman, PwC Bermuda leader, said, "Operational risk continues to be the key category of risk occupying insurers' boardroom conversations in all sectors including life, non-life, broking, composite and reinsurance. While there is a pressing need for better and efficient technology, in the era of digitalisation, the threat of cybercrime has become ever more prominent. Insurers' concerns about regulatory risk were also generally high."

Differences were found mainly in the assessment of interest rate risk which life insurers ranked high along with investment risk, and climate change which was particularly flagged as a concern by the reinsurance sector. Concern about the macro-economic outlook was highest among life insurers and reinsurers.

Survey comments:

- *The CFO of a reinsurance company said: "Large organizations will struggle to implement technology changes quickly but may be protected by the barriers to entry in this industry, which include know-how, capital and regulatory restrictions. It is not cheap to operate in this space."*

- *A respondent in Hong Kong said: "Lots of insurers are trying to write cyber policies, but the potential impact of cyber insurance claims is still very much unknown."*

- *Another in the UK observed that: "Cyber coverage/exclusion contracts are yet to be really tested."*

- *A respondent in India said: "If Global Warming increases the number of disasters, reinsurance pricing could produce shocks for the insurance industry."*

- *A regional chief executive of a Chinese reinsurer said: "Many P&C insurers are not taking out adequate reinsurance protection as they want to reduce the cost of protection. This may result in sizeable financial impact to their capital."*

- *CEO of a composite insurer in Belgium: "We see Insurtech more and more focusing on parts of the value chain and looking for distribution capacity (to be found at insurers). So less a disruptive force, more as partners."*

- *An executive director at an insurance broker in the UK, said: "Pressure on costs is weighing more heavily on individual employees with increased risk of burnout without any commensurate material compensation. Years of 'soft markets' have also seen a drain of experience as 'more expensive individuals' are culled and with them irreplaceable knowledge."*

- *The chief risk officer of a Bermuda-based insurer said of Brexit: "The uncertainty has already been baked in and most organisations have had to make contingency plans; the downside risk is now contained."*

Big movers
This year's survey has produced striking changes in the ranking of some Banana Skins, reflecting shifting perceptions of risk in a difficult market.

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- Regulation (No. 4). A heavy regulatory agenda including the insurance accounting standard IFRS 17 and consumer protection has increased compliance risk and implementation costs.

- Climate change (No. 6). The spate of natural catastrophe events has increased the urgency of this risk, and could be undermining insurance pricing models.
- Reputation (No. 13). Data security, populist politics and 'declining social relevance' could all damage insurance.

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- Interest rates (No. 10). The industry has learnt to live with low interest rates, and the next move may be up.
- Guaranteed products (No. 14). For similar reasons, products which offer guaranteed returns appear less problematic.
- Social change (No. 18). Seen as an opportunity rather than risk – as the industry is preparing for the challenge of meeting social demands created by greater longevity, growing medical and care needs.

Brexit ranked 21 on this year's list as most respondents outside of the UK and EU believed they were insulated from any potential fallout, even judging Brexit to be 'a non-event' according to the report. Global respondents reported being only distantly affected, alongside being adequately prepared.

Perhaps unsurprisingly the greatest concerns came from the UK, where insurers said that the loss of direct access to the EU market would damage existing business and hamper growth.

Damian Cooper, PwC Bermuda, Partner, Insurance noted that in 2017 regulation fell overall with change management rising as the top risk. Two years on, the sector is now projecting a rise in the threat of regulatory risk.

"This has been driven by new areas of regulation introduced since 2017 including General Data Protection Regulation (GDPR) in Europe and various new conduct standards across the globe," Mr Cooper said. "The pressure applied by upcoming new accounting standards, particularly IFRS 17 has amplified the issues. The task of addressing and implementing these new regulatory standards, in the mandated time frame, is proving to be a challenge for insurers everywhere."

About CSFI

The Centre for the Study of Financial Innovation is a non-profit think-tank, established in 1993 to look at future developments in the international financial field – particularly from the point of view of practitioners. Its goals include identifying new areas of business, flagging areas of danger and provoking a debate about key financial issues. The Centre has no ideological brief, beyond a belief in open markets.

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