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INSURANCE ADVISOR

3 NOTABLE ACCOUNTING UPDATES FROM THE SPRING NAIC MEETING

By Richard Bertuglia and Peter Popo

The 2017 National Association of Insurance Commissioners (NAIC) Spring Meeting took place April 8-11 in Denver.

During the meeting, the Statutory Accounting Principles (E) Working Group adopted revisions to several statutory accounting principles, three of which we've outlined below. While these revisions do not become final until adopted by the Plenary of the NAIC, it's critical that all insurers keep them in mind when considering their financial reporting practices.

SVO-IDENTIFIED INVESTMENTS

Revisions to *Statement of Statutory Accounting Principles (SSAP) No. 26R—Bonds and Issue Paper No. 156—Bonds* remove Securities Valuation Office (SVO)-defined instruments from the definition of a bond and provides separate guidance for these instruments. The substantive revision also incorporates the definition of "security" within the definition of a bond. Non-bonds and fixed-income instruments within the scope of *SSAP No. 26* are also defined. Revisions are effective Dec. 31, 2017 with specific transition guidance established within the SSAP.

DID YOU KNOW...

According to a recent survey from AICPA and the Enterprise Risk Management Initiative at the Poole College of Management at North Carolina State University, about 70 percent of executives believe the risks their companies face has increased in both volume and complexity over the past five years.

A new survey from Willis Towers Watson found that there was a 10 percent increase in the number of property/casualty (P/C) insurers using predictive models for underwriting and risk selection.

Insurers are raising prices, with a composite rate index increase of more than one percent in Q1 2017, according to online insurance exchange MarketScout.

Eighty-eight percent of P/C industry leaders surveyed at the Insurance Information Institute's 21st annual Property/Casualty Insurance Joint Industry Forum believe cyber insurance will grow faster than the rest of the P/C industry.

Fitch Ratings found that American P/C insurers operating return on average equity fell to 6.6 percent, down from 7.4 percent in 2016.

CONTINUED FROM PAGE 1

NAIC MEETING

Statutory Accounting Principles have historically allowed certain fund investments noted by the SVO to be reported as bonds within SSAP No. 26. The SVO-identified investments captured within the scope of SSAP No. 26 are limited to bond mutual funds and exchange traded (ETF) bond funds that meet certain criteria. The bond mutual funds must invest 100 percent of its total assets in U.S. government securities, class 1 bonds that are issued or guaranteed as to payment of principal and interest by agencies and instrumentalities of the U.S. government, and collateralized repurchase agreements. ETF's cannot invest in common stock or any material holding incompatible with debt-like or preferred-like stock treatment accounted for under SSAP No. 26.

Accounting Revisions

SSAP No. 26 requires an amortized cost or fair value measurement method depending on the NAIC designation for the investment. As the SVO-identified investments are equity/fund investments, without a stated par value, interest rate or maturity date, they do not "amortize" like bonds or other fixed-income instruments. The NAIC Working Group noted that fair value (allowing net asset value as a practical expedient) was the most appropriate measurement method for the SVO-identified equity/fund investments. However, small and medium-size insurers expressed concern that financial statements could reflect volatility from the fair value fluctuations. The potential for this volatility may cause small and medium-size insurers to liquidate these investments, based on their investment policy requirements, and incur greater investments costs in order to directly acquire bonds. In response to these concerns, the Working Group agreed to allow entities to elect an optional measurement method for these investments referred to as the "systematic value" to reflect the systematic recognition of cash flows from the underlying bond holdings.

Certain criteria must be met for the investment to be reflected using a systematic value measurement method:

NAIC Designation:

SVO-identified investment must have a qualifying NAIC designation of NAIC 1 to 5 for Asset Valuation Reserve (AVR) filers, and NAIC 1 or 2 for non-AVR filers.

Irrevocable Election:

Reporting entities must make an irrevocable election by CUSIP to use systematic value at the time the investment is originally acquired. This election shall remain as long as the investment (by CUSIP) is held. Subsequent acquisitions of the same ETF by CUSIP, if it is already held, are required to follow the same measurement method originally elected. There is specific guidance for investments held that are subsequently added or removed from the SVO-identified list or have changes to the NAIC designation criteria after acquisition.

Under the irrevocable election guidance, a reporting entity could sell an entire investment (all of a particular CUSIP), reacquire the same investment, and make an election to apply a different measurement method. However, the guidance includes restrictions to prevent a change in measurement method in response to wash sales, and to prevent different measurement methods within an interim period. As such, a change in measurement method is only permitted if the reacquisition occurs 90 days after the full-sale (complete elimination of the CUSIP) of the SVO-identified investment.

Systematic Value Determination:

The guidance standardizes the approach in determining systematic value for all SVO-identified investments a company elects to report at systematic value. Deviating from the standard systematic value approach would be considered a permitted practice requiring domiciliary approval. An insurer must provide information to determine systematic value using

CONTINUED FROM PAGE 2

NAIC MEETING

the standard approach (e.g., cash flow details for underlying bonds) at the time of original election for systematic value, otherwise the SVO-identified investment would not be permitted to be designated for systematic value unless a permitted practice is obtained.

The systematic value shall reflect an "aggregate cash flow" method in which the cash flow streams from the individual bond holdings are aggregated into a single cash flow stream. These cash flows are scaled such that, when equated with the market price at which the ETF was purchased or sold, an internal rate of return is calculated, representing the investor's initial book yield for the ETF. Although the initial book yield is utilized to determine the current period effective yield, and the resulting adjustments to the ETF's reported (systematic) value, the book yield is recalculated at least quarterly in order adjust the investor's book yield to reflect cash flow projections of the current bond holdings within the ETF. For an illustration of this method, readers should turn to Exhibit B within the SSAP.

Other-Than Temporary Impairment (OTTI) for SVO-Identified Investments

The revised guidance requires assessment of OTTI in response to adverse changes in estimated cash flows of ETFs reported at systematic value, including several situations:

- A decision to sell an SVO-Identified investment that has a fair value less than systematic value.
- In situations in which an SVO-identified investment has a fair value that is less than systematic value, the reporting entity must assess for OTTI. For these investments, a key determinant, along with other impairment indicators, will be whether the net present value of the projected cash flows for the underlying bonds in the SVO-identified investment have materially declined from the prior reporting period.

Upon identification of an SVO-identified investment as OTTI, the reporting entity needs to recognize a realized loss equal to the difference between systematic value and the current fair value. In calculating the measurement of the OTTI loss, the fair value of the SVO-identified investment will become the new cost basis of the investment. After recognition of an OTTI, the SVO-identified investment is required to be reported at the lower of the then current period systematic value or fair value.

Systematic Value Disclosures

The guidance to allow a "systematic value" measurement method incorporates additional disclosures for reporting entities electing this measurement method. These disclosures include information on the approach for determining systematic value, whether the reporting period entity consistently uses fair value or systematic value for all SVO-identified investments, or if any investments are being reported differently from the prior reporting period and no longer qualify for the systematic fair value measurement method.

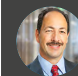
DISCLOSURES ABOUT SHORT-DURATION CONTRACTS

The Statutory Accounting Principles Working Group rejected FASB *ASU 2015-09: Insurance – Disclosures about Short-Duration Contracts*. However, an additional disclosure requirement from this ASU was added to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. This additional disclosure requires the inclusion of information about significant changes in methodologies and assumptions used in calculating the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements for the most recent reporting period presented.

STATEMENT OF CASH FLOWS

SSAP No. 69—Statement of Cash Flow was revised to adopt the provisions of FASB *ASU 2016-15 – Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*, including the related effective date and transition guidance. The revisions include specific guidance for the presentation of debt prepayment and debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, distributions received from equity method investees and beneficial interests in securitized transactions.

For more information on this meeting and other non-substantive revisions adopted at the Spring Meeting, visit the Statutory Accounting Principles (E) Working Group's website: http://www.naic.org/cmte_e_app_sapwg.htm



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INSURANCE INDUSTRY PERFORMANCE RECAP

By Imran Makda

Property & Casualty (P&C)

Net income for P&C sector slipped 23.8 percent in 2016 to $44.4 billion, compared to $58.3 billion 2015 due to worsening underwriting results coupled with declining investment yields and realized capital gains. Both direct and net written premiums (NWP) grew slightly in 2016; NWP grew by 2.5 percent in 2016, but the growth rate slowed compared to last five years. From 2011 to 2015 NWP grew in the range of 3.5 percent to 4.5 percent each year. Personal lines showed continued growth in both Homeowners and Private Passenger Auto segment with combined growth in NWP of 5.6 percent, or $15.6 billion. Commercial lines continued their decline again in 2016, with NWP declining 1.2 percent, or $2.9 billion for the sector.

Coupled with anemic premium growth, loss ratio (72.3 percent in 2016 vs. 69.3 percent in 2015) and combined ratios (100.7 percent in 2016 vs. 98.0 percent in 2015) both increased, resulting in underwriting loss of $2.3 billion. This represented the first year of underwriting loss since 2012. The combined ratio for Personal Lines segment increased by 1.7 percent to 102.4 percent in 2016. For Commercial Lines segment, the combined ratio increased by 3.9 percent to 97.5 percent in 2016. According to SNL, favorable development of loss reserves for prior accident year declined 39.7 percent in 2016 to $4.4 billion, compared to $7.3 billion in 2015. More specifically, AIG took a prior year adverse development charge of $5.6 billion in the fourth quarter of 2016, and State Farm recorded a charge of $1.2 billion in its private passenger auto liability line in 2016. Net investment income and realized gains declined $2.9 billion, in part because net yield on invested assets declined to 3.0 percent in 2016 compared to 3.2 percent in 2015, also contributing to lower net income.

Over the last twelve months, the S&P 500 P&C Index have generated 16.0 percent returns, compared to 17.0 percent returns generated by the S&P 500 Index. Some positive signs moving forward include continued reduction in the unemployment rate and higher levels in the Consumer Confidence Index (CCI). In April, the economy added 211,000 jobs, and the unemployment rate dropped to 4.4 percent, according to U.S. Department of Labor. During the same month, the CCI registered at 120.3, down slightly from March's 125.6 but still trending at levels not seen since 2000. Strong economic and

CONTINUED FROM PAGE 4

INDUSTRY PERFORMANCE

business indicators should bode well for the P&C sector in 2017, with continuing overall growth in direct written premiums for both personal and commercial lines.

According to S&P Global Market Intelligence, 2016 saw 36 new insurance startups, the highest number since 2009. FinTech, and more specifically InsureTech, continues to generate both hype and investor funding. Companies like Lemonade have gained prominence at the national stage, which has promised to change the game and has pledged to drag the industry "out of the 18th century." Lemonade, a homeowners and renter insurance company, is expected to complete a nationwide rollout later this year. It is clear the industry is long overdue for a change. Companies that invest in, and are at the fore front of, technological advances—such as predictive modeling, harnessing big data, internet of things or artificial intelligence—will eventually come out on the top.

Life Sector

The life sector continued its upward momentum in 2016, hitting $67.1 billion in pre-tax operating income, representing a 23.3 percent increase over 2015 and the highest mark the sector has seen in five years. Net income declined 2.1 percent to $39.4 billion, driven by significantly higher realized capital losses compared to 2015. Premiums and annuity consideration declined $38.3 billion (or 6.0 percent) in 2016 to $600 billion with life premiums accounting for majority of the decrease. Overall life premiums decreased 24 percent, to end with $115 billion for 2016. Annuity premiums declined 1.7 percent to $318.5 billion, and Accident & Health premiums increased 2.5 percent to $162.9 billion.

Investment income increased $2.2 billion to $173.0 billion in 2016. Investment yield has been on the continuous decline over the last six years, down from a high of 5.1 percent in 2011 to a low of 4.6 percent in 2016. The yield may get some additional relief in 2017, as the Federal Reserve has begun to raise interest rates. The Federal Reserve has moved forward with its tightening bias, raising the federal funds rate twice since December. Capital and surplus grew to $380.6 billion, an increase of 3.7 percent, or $13.4 billion, over 2015. This marks the ninth consecutive year of capital growth since the financial meltdown in 2008. This also marks the ninth consecutive year of continuing increase in dividends to stockholders, which reached $33.1 billion in 2016, compared to $25.2 billion in 2015. When compared to P&C, the life sector has produced higher return on the average equity over the last five years, delivering 10.5 percent in 2016 and 11.2 percent in 2015.

Over the past year, the S&P 500 Life & Health Index has increased 31.2 percent, outperforming the S&P 500 Insurance Index, which returned 20.5 percent during the same period. The overall consensus for the first quarter 2017 earnings season is that life insurers will continue to see year-over-year earnings growth. Most companies will likely benefit from the Federal Reserve's interest rate hike in March. There is added uncertainty, however, due to Trump administration's delay of Department of Labor Conflict of Interest rules. The industry as a whole continues to deal with long-term issues, such as technological innovation and a generational marketing gap. As evidenced by the year-over-year decline in life insurance premiums, millennials are much less interested in purchasing these products, and the industry has yet to find digital and social media solutions that reach this demographic.

Health Sector

The health sector underwriting volumes dipped to $11.3 billion in 2016, compared to $13.9 billion for 2015. Net income for this sector also declined by 9.3 percent, or $826 million, to $8.1 billion for 2016. The industry continued to suffer additional losses from uncertainty and non-payment of risk corridor receivables by the federal government. As a result, several insurers have filed lawsuits against the federal government seeking payment and announcing plans to either scale back or discontinue their participation in state-run exchanges.

Direct premiums written grew by 7.4 percent in 2016 to $637 billion, while the claim loss ratio stayed relatively flat to 89.2 percent in 2016, compared to 89.3 percent in 2015. The Combined ratio for the industry also improved slightly to 99.1 percent in 2016, compared to 99.4 percent in 2015. The industry reported a 6.7 percent increase in investment income, which totaled $3.5 billion in 2016, while investment yield stayed relatively flat at 2.0 percent. Another positive sign for the industry was the continued increase in premium per member month, which was $241 in 2016, compared to $232 in 2015. This premium increase improved bottom line performance for several insurers that chose to stay in the ACA marketplace.

As the first quarter 2017 earnings season started, analysts have predicted that most large managed care insurers should show strong first quarter results as a result of their exiting the ACA marketplace in 2016. These carriers, including United Health and Humana, announced significant losses in 2015 and 2016 as a result of their participation in the ACA. Cigna already reported first quarter adjusted operating income of $2.77 per share, beating both the $2.32 per share for the same period a year ago and the analyst consensus of $2.46. There is added uncertainty and instability in the market place, however, due to the recent passage of new Republican healthcare bill and the looming tax reform proposal. The healthcare bill has received mixed reviews from various constituents. The CEOs from United Healthcare and Anthem both stressed the need to repeal ACA tax permanently, which is slated to be reinstated in 2018 under the current law if the tax is not repealed.

CONTINUED FROM PAGE 5

INDUSTRY PERFORMANCE

LARGEST INSURANCE UNDERWRITER AND BROKER DEALS ANNOUNCED IN 2016

Ranked by disclosed deal value as of announcement

Announcement date	Buyer (ticker)	Buyer country	Target (ticker)	Deal value ($M)
10/05/16	Sompo Holdings Inc. (8630)	Japan	Endurance Specialty Holdings Ltd. (ENH)	6,303.8
12/05/16	Liberty Mutual Holding Co. Inc.	USA	Ironshore Inc.	3,000.0
10/23/16	China Oceanwide Holdings Group Co. Ltd.	China	Genworth Financial Inc. (GNW)	2,728.8
07/18/16	Berkshire Hathaway Inc. (BRK.A)	USA	Medical Liability Mutual Insurance Co.	1,451.8
11/28/16	Allstate Corp. (ALL)	USA	SquareTrade Holding Co. Inc.	1,400.0
11/17/16	Wellcare Health Plans Inc. (WCG)	USA	Universal American Corp. (UAM)	600.4
02/24/16	BB&T Corp. (BBT)	USA	Swett & Crawford Group Inc.	500.0
04/13/16	Assured Guaranty Ltd. (AGO)	Bermuda	CIFG Holding Inc.	450.0
01/21/16	Aviva Plc (AV.)	U.K.	RBC General Insurance Co.	399.1
01/25/16	National General Holdings Corp. (NGHC)	USA	Century-National Insurance Co./Western General Agency Inc.	315.0

Data compiled Jan. 13, 2017,
Includes property and casualty, life and health, and managed care deals announced between Jan. 1, 2016 and Dec. 31, 2016.
Includes whole-company, minority and asset deals in which the target is based in the U.S., Canada or Bermuda.
Excludes terminated deals.
All metrics are as of announcement date.
Source: SNL Financial, an offering of S&P Global Market Intelligence

Several states, including Massachusetts, New York and California, have voiced their discontent with the current bill, which proposes to change the current Medicaid funding mechanism to block grant funding. This move could significantly reduce the critical funding required for the program and will reduce access to low-cost healthcare for millions of Americans. The fate of the final bill remains unknown as several GOP Senators stated that they will write their own version of the bill instead of using the current version passed by a razor thin margin in Congress.

MERGERS AND ACQUISITIONS (M&A)

An S&P Global Market Intelligence analysis found that there were 544 deal announcements in the insurance sector in 2016, with an aggregate disclosed deal value of $27.4 billion. Those numbers represented a significant drop in both volume and transaction value from 2015, which saw 604 deals with a total disclosed deal value of $164.2 billion. According to S&P Global Market Intelligence, below were some of the most notable deals announced in 2016:

Last year also saw a large volume of terminated deals in the managed care space—including the termination of the Anthem/Cigna and Aetna/Humana deals, which represented a collective deal value of $83.6 billion. Deal making activity also started out sluggishly in the first quarter of 2017, according to S&P Global Market Intelligence. There were 11 insurance underwriter deals announced in the quarter, totaling $375.7 million in deal value, compared with 35 announced deals worth $13.55 billion in the fourth quarter of 2016. For insurance brokers, there were 122 announced deals with a total value of $343.3 million in the first quarter of 2017, compared with 119 deals worth a total of $4.6 billion announced in the fourth quarter of 2016. According to most experts, the biggest underlying factor behind the slow pace is the unstable political environment, which includes new healthcare legislation, postponement of DOL's Fiduciary rule and pending tax reforms.

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BDO AND HERRICK FEINSTEIN LLP DISCUSS NEWLY IMPLEMENTED NYDFS CYBERSECURITY REGULATION AT JOINT BREAKFAST PANEL

By BDO and Herrick Feinstein Partners

On March 28, BDO co-sponsored a cybersecurity breakfast panel, *"New York DFS Cybersecurity Regulation—The New Normal,"* with law firm Herrick Feinstein at their offices in New York.

The event, which featured a joint panel with Herrick's Richard Morris and Erica Markowitz and BDO Consulting Managing Directors Judy Selby and Michael Stiglianese, focused on how financial institutions can comply with the newly implemented New York Department of Financial Services (NYDFS) cybersecurity regulation.

As noted in a previous alert, the regulation requires financial institutions that do business in the State of New York to conduct a risk assessment and maintain a risk-based cybersecurity program. The regulation, which includes certain minimum regulatory standards, is designed to protect customers' private data and ensure the safety and soundness of New York's financial services industry.

Below are what we gleaned to be the top event takeaways:

- **The new DFS regulation is groundbreaking in scope, in its level of prescription and accountability.** New York will be deemed the leader, but regulators are likely to look to the DFS regulation as a minimum standard for cybersecurity.
- **While there are exemptions, most are limited and pertain primarily to small entities.** Even though an organization falls within a limited exemption, it must still comply with many of the key requirements of the regulation and will be required to go through periodic processes to re-affirm they qualify for exemptions.
- **DFS has broad authority to bring enforcement actions for noncompliance,** and while it is still unclear what enforcement profile the DFS will elect to adopt, possible remedies may include fines, license revocation, and/or the engagement of an independent monitor, among others.
- **Liability will extend beyond the DFS.** A cyber event that causes a loss to your clients or business will expose you to possible class action and other litigation and claims. Organizations need to prepare their records and documentation for the inevitable cyber event, including a robust response plan.
- **Consider cyber insurance, but make sure it covers your company's unique cyber risk profile. Look for coverage for regulatory fines and for security incidents for data controlled by service provides.** Require third-party service providers carry their own cyber insurance and make sure their coverage will apply if there is a breach involving data in their possession. In addition, check levels of D&O coverage in light of the new responsibilities imposed by the DFS.
- **Add "notify your insurance carriers" to your incident response plan.** Insurance may not be top of mind when a security event takes place but most cyber insurance policies require prior consent of the insurer before you incur any expenses in connection with the event.

Financial services institutions should also remember the following key points:

- **Board members and senior management are now responsible for cybersecurity.** Under the regulation, a member of the board or senior officer must personally certify compliance on an annual basis.
- **Non-exempt covered entities need a Chief Information Security Officer ("CISO").** While you can elect to outsource the CISO role to a third party, you cannot outsource responsibility for oversight or accountability as DFS requires that someone within the company oversee the CISO. You cannot delegate your obligation.
- **Look at third-party service providers as an extension of your own organization.** The regulation requires companies to vet and manage service providers that access or control nonpublic information. A risk assessment should be undertaken to ensure all service providers are in compliance with your policies – your policies should take precedence.
- **Organizations should comply prior to the compliance date.** Compliance obligations exist now because of your fiduciary duties. You cannot look to a client and note that a breach occurred prior to the compliance date and expect that will assuage their response.

With the NYDFS cybersecurity regulation now in effect, companies must ensure that they have the necessary cybersecurity and compliance programs in place with the proper personnel, policies and processes. Financial institutions should also take care to ensure that their cyber insurance policies adequately cover their unique cyber risk profiles.

BDO works with insurers and financial institutions to develop a comprehensive approach to cybersecurity and compliance, taking a 360-degree view of information risk and opportunity. We are well-versed in the DFS regulation, and well-equipped to help clients quickly address any areas of noncompliance. BDO's Cybersecurity Risk Assessment Portal, our proprietary state-of-the-art online tool, provides a cost-effective assessment and an easy-to-understand scorecard and report, highlighting areas of strength and uncovering areas for improvement.

INSURTECH IS GROWING. ARE YOU READY?

By Michael Dombrowski

Many in the insurance industry complain that traditional insurers operate inefficiently, and are reliant on legacy technology systems.

While it's true that traditional property/casualty (P/C) insurance companies can be slow to adapt, the industry remains consumer facing and increasingly data-intensive, and thus primed to be revolutionized by new and emerging technologies.

As was the case in the hospitality, banking, and retail industries over the past several years, the insurance industry stands on the edge of disruption, thanks to a crop of technology-first insurance startups, or InsurTech, firms. These companies seek to upend the traditional structure of the P/C insurance value chain by using technologies and platforms designed to simplify processes and create more user-friendly customer experiences. These startups help traditional insurers leverage internal and external data to gain insights into customers, pricing selection, risk assessments, and underwriting processes.

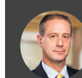
As Jim Evans noted in a recent Q&A, investors are also taking note of this growing trend. According to CB Insights, over $1.69 billion was invested in insurance startups in 2016, and the volume and value of deals have almost doubled since 2014. While it might sound like traditional P/C insurers should prepare themselves for potentially catastrophic disruption, the rise of these startups provides insurers with opportunities to maximize technology to further their own successes. (Read more in the Perspective in Insurance.)

Most InsurTech companies focus on a discreet aspect of the value chain, be it distribution, sales, underwriting, customer service, or niche products like behavior-based insurance. Given that these startups don't have ambitions of being end-to-end carriers, their unique areas of expertise can be viewed as a value-add and rapid innovation rather than competition, providing potential partnership opportunities for insurers looking to increase efficiencies. Some big insurers like AXA, which recently partnered with Silicon Valley startup Trov to develop a millennial-focused, mobile based service offering, are already finding value in working with these new industry players. But opportunities don't start and end with mobile—many InsurTech firms use some of the following innovations to help the traditional industry players solve pain points in the back and middle office:

- **Intelligent automation**: Artificial intelligence (AI) can automate some of the industry's most time-consuming administrative work, completing forms and customer communications traditionally handled by employees as well as processing claims and fighting fraud. Startups like Spixii and Neosurance already use AI insurance agents to assist in underwriting processes and customer relations, and Japanese Fukoku Mutual Life Insurance replaced 34 employees with IBM's Watson AI.
- **Internet of Things (IoT):** Connected devices measure data in close to real time, allowing underwriters to calculate risks, and shift premiums and policies more dynamically than ever before. In the case of DigitalTech-International, this takes the form of a "software as a service" offering that connects data gathering to service delivery via a mobile-based agent team.
- **Blockchain:** Blockchain is already taking the banking industry by storm, and can give insurers the fraud prevention and proof of identity necessary to provide coverage in safe and transparent ways, leading to cost savings along the way. Everledger, for example, uses blockchain to create a record of transaction details of diamonds to reduce risks for banks and insurers. Recently, a South Korean life insurance company announced it would test blockchain technology in its insurance payments process.

InsurTech companies also benefit from working with their industry forbearers. For many startups seeking VC and private equity funding, traditional insurers offer a vehicle to rapid scaling and commercialization that demonstrates worth to potential investors.

One of these insurance companies could be the next Uber or Airbnb. Whether through partnerships or organic innovations, customers have come to expect their service providers, including insurers, to move towards providing user-centric products aligned with their mobile-first lifestyles. Cooperation between traditional insurers and InsurTech can lead to added benefits for all parties involved. Insurance companies that are willing to ride the wave of transformation and partner with innovative startups may thrive, while those resistant to change risk being left behind.



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PErspective in INSURANCE

A FEATURE EXAMINING THE ROLE OF PRIVATE EQUITY IN THE INSURANCE INDUSTRY.

Private equity (PE) investment in the insurance industry is predicted to grow substantially this year as emerging market risks, in combination with global economic optimism, continue to contribute to sector growth. Dealmaking, too, can be expected to increase, following robust mergers and acquisitions (M&A) activity in the industry in 2015 and 2016.

Last year saw PE-backed insurance firms Acrisure, Hub International and AssuredPartners among the top acquirers. This year expects PE involvement in M&A activity to remain equally, if not more, strong, as insurance companies look toward M&A to enhance current operating models, scale service offerings, expand to new markets, outpace competitors and keep up with today's rapid pace of innovation. With more players on the field, industry consolidation will be a critical theme as insurers look to add income streams to increase their bottom lines.

Technology adoption, especially, will be a main driver of M&A activity in 2017, with Internet of Things (IoT), cybersecurity, data analytics and enterprise software companies among the top targets. According to a recent Mergermarket and Willis Towers Watson **survey**, almost half (45 percent) of survey participants cited M&A as the way forward to technology advancement, as opposed to only 17 percent quoting internal development. The appetite is only growing, with almost half of participants (49 percent) expecting to make an acquisition related to digital technologies over the next three years, and 14 percent expecting to make more than one acquisition.

In fact, insurers and reinsurers **completed** 100 strategic investments in private tech companies in 2016, according to CB Insights. Among the companies to launch VC initiatives last year were Liberty Mutual, Insurance Australia Group and CUNA Mutual. In January 2017, Northwestern Mutual formally **announced** the creation of a new $50 million Northwestern Mutual Future Ventures fund, which will "engage startups whose technologies have the potential to transform how consumers experience and achieve financial security."

Insurtech is also making inroads, with investor interest continuing strong. Last year saw insurtech deal activity **hit** its highest annual amount, with approximately $1.69 billion in total funding going to insurance startups globally, according to CB Insights. U.S.-based startups received over half (59 percent) of the funding, and two-thirds of the deals took place at an early stage (Seed/Series A). For example, Japanese insurer Sompo Holdings and HSB Ventures, Inc., the VC arm of Munich Re, both had **invested** $85 million in Trov, a U.S.-based tech startup that provides on-demand insurance, in early April.

International dealmaking is also **expected** to be prevalent in 2017, though slightly more subdued than previous years, according to Bloomberg. Asian investors, especially from China and Japan, have invested heavily in the U.S. insurance industry in the past, with Chinese insurers **spending** $100 billion on deals over the past three years. A Clyde and Co. **report** additionally noted that in 2016, 12 of the top 20 completed deals by value involved an Asia-based acquirer.

Whether 2017 spending levels will mirror 2016 levels remains to be seen, especially in consideration of a recent **announcement** by the China Insurance Regulatory Commission of its increased scrutiny and tightening control of the industry. Nevertheless, foreign investment will continue as insurers look to gain a foothold in the U.S. market.

FUTURE PERSPECTIVES: WHAT'S NEXT FOR INSURANCE INVESTORS?

While insurance companies can celebrate over the recent interest rate hike, much uncertainty still exists. The administration's decision on whether to scale back Dodd Frank regulatory measures stands to significantly impact insurers of systemically important financial institutions (SIFI), such as MetLife, Prudential and AIG.

The administration's approach the updated Department of Labor Fiduciary Rule is another factor for consideration. The updated rule, which includes insurance companies, was slated to become effective April 10, but has been postponed until June 9 by a Feb. 3 memorandum by President Trump. Insurance companies will continue to watch for any new developments that could affect them in this area.

PE investment in insurance is still expected to continue, but global and national risks may lead PE and VC firms to tread cautiously in their investments over the next few months.

Sources: *Bloomberg Markets, Business Insurance, CB Insights, Forbes, Mergermarket, Northwestern Mutual, Reuters, Willis Towers Watson*

MARK YOUR CALENDAR...

MAY

May 21-25
AAMGA 91th Annual Meeting 2017
Orlando World Center
Orlando, Fla.

May 22-26
NAIC Insurance Summit
Sheraton Kansas City at Crown Center
Kansas City, Miss.

JUNE

June 4-7
IASA's 2017 Annual Educational Conference and Business Show
Orlando World Center Marriott
Orlando, Fla.

June 7-9
IICF Women in Insurance Global Conference
Sheraton New York Times Square Hotel
New York

June 15-17
IAIP 76th Annual Convention
Hotel Albuquerque
Albuquerque, N.M.

JULY

July 10-12
ACLI's Compliance & Legal Sections Annual Meeting
The Coeur D'Alene Golf & Spa Resort
Coeur D'Alene, Idaho

July 13-15
NCOIL 2017 Summer Meeting
InterContinental Chicago Magnificent Mile
Chicago

July 17-20
IIS Global Insurance Forum
Park Plaza Westminster Bridge Hotel
London

BDO INSURANCE PRACTICE

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