

THE FUTURE OF INSURANCE



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INTRODUCTION

“Challenge to change” is a three-part white paper series that explores the future growth drivers of the global Insurance industry. The papers, entitled “Embracing Change,” “The Impact of Technology” and “The Future of Insurance,” look at the economy, regulatory landscape, technological innovation, business process, workforce and talent issues, and many other areas. They examine the drivers, opportunities and challenges of an incredibly rich and evolving sector. The “Challenge to Change” series is for multiple insurance businesses - from Life to Property and Casualty, Large Commercial to Long Term Care - across multiple delivery channels and operations types. It is designed to be an important discussion tool to facilitate strategic thinking about how to create new business opportunities and respond to challenges positively.

This paper looks at “The Future of Insurance.” Leading experts are making compelling arguments that insurance needs to change. While the challenge to change is significant, the benefits of doing so are growing in an increasingly global industry.

EVOLVING BUSINESS FOUNDATIONS

Vendor beware

With technological complexity increasing and people's lives increasingly time-pressured, it is no longer reasonable to live in a "buyer beware" society. The burden of protection will increasingly fall on those creating the product or service, in part because any lack of transparency risks being highlighted and widely disseminated via social media, but also because trust in financial services is low and the industry cannot afford for it to fall further. Only 48% of people globally trust financial services, fewer than any other monitored industry groupingⁱ. Within this grouping, 47% trust insurers, fewer than banks (52%) or credit card companies (52%, see Figure 1). It appears the challenge for insurers is to be completely transparent and compliant with regulatory issues (which may bring more scrutiny), while also reducing the perceived complexity of their products and services. In short, they have to meet and exceed customer expectations.

In the future, insurers will be able to micro-analyze every insured entity.

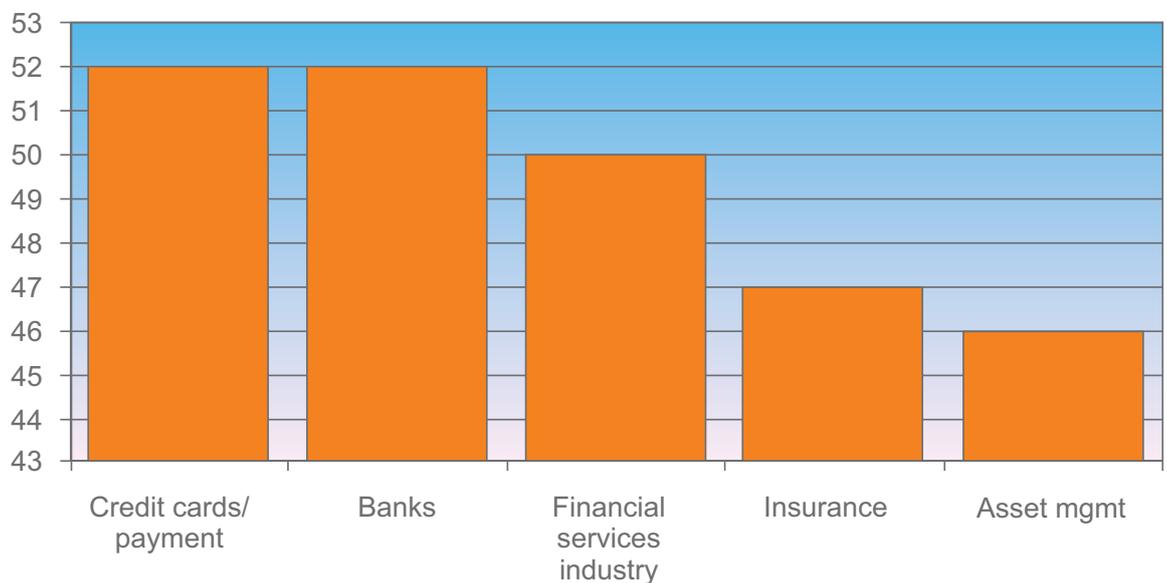


Figure 1: Trust levels (as a percentage) of the industry and its constituent partsⁱⁱ

Mass customization

The profusion of data and emerging forms of better analytics, together with viral forms of human connectedness, could markedly increase complexity within the industry. Mass customization of products, for example, will be expected by consumers who are increasingly knowledgeable, demanding, networked and vocalⁱⁱⁱ. In short, the industry "will have the ability to craft reliable probabilities around small groups, even a single individual or event^{iv}." The shift towards people-centric policies will cause some of the core principles on which the industry has historically been built to be closely re-examined and reworked. The international insurance think tank, The Geneva Association, believes that "a paradigm shift from historic to predictive risk assessment methods is necessary."^v An applied customer focus is reason enough to warrant this change, with research suggesting that up to \$600 billion of global consumer demand is prone to switching insurance providers in 2014^{vi}. It is implicit that granular predictive models will be necessary to accommodate such a shift. Emerging typologies of insurance, such as Takaful – the co-operative Islamic system of reimbursement that is expected to grow by 16% annually in coming years^{vii}, also hint at changing market dynamics and an added degree of complexity for those aiming for mass customization.

i Source: Edelman, 2014 <http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/trust-in-business/trust-in-financial-services/>
ii Source: Edelman, 2014 <http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/trust-in-business/trust-in-financial-services/>
iii Source: Gaurav Bhalla, retrieved August 2012 <http://www.gauravbhalla.com/publications/collaboration-and-co-creation/>
iv Source: Futurist Speaker, 2012 <http://www.futuristspeaker.com/2012/05/transforming-the-future-of-the-insurance-industry/>
v Source: Canadian Underwriter, 2013 <http://www.canadianunderwriter.ca/news/cat-risk-assessment-must-shift-from-historic-to-predictive-methods-report/1002421018/>
vi Source: Accenture Insurance Blog, 2014 http://insuranceblog.accenture.com/getting-to-grips-with-the-switching-economy-in-insurance/?cid=fs_insblogfy14_10000255_smc_0913#sf22269992
vii Source: Zawya, 2013 http://www.zawya.com/story/Thomson_Reuters_announces_findings_of_annual_sukuk_perceptions_and_forecast_study-ZAWYA20131120115713/

Shifting sands

What passes as a certainty today may become more uncertain in the future. For example, many medical conditions such as AIDS and some late stage cancers are all but incurable under contemporary medical technology. Nanotechnology and the development of personalized medicine may offer the resolution (or perhaps even prevention) of such conditions in the future. Such significant changes are not confined to medical technologies, however. Culturally, a shift towards the local and sustainable might render some future insurance claims difficult to remedy with a monetary-only solution, especially where the monetary value is low but the value placed on items is high. Might this be an area of Corporate Social Responsibility (CSR) that insurers could develop, or could value-adding services flow from such circumstances?

Measure everything

“The Principle of Loss Minimisation will become a focal point of many future court battles as the pervasiveness of photos, voice, and video recording becomes more prevalent^{viii}.” The need to demonstrate advantages for consumers will be pressing, as the range of potential privacy issues is broad. But evidence suggests significant benefits for those who embrace the complexities of big data. In 2013, IBM found that 74% of insurance companies surveyed reported that the use of information (including big data) and analytics was creating a competitive advantage for their organizations, compared with 63% of cross-industry respondents. Insurance use of big data in 2012 represented a 111% increase in just two years^{ix}.

viii
ix

Source: Futurist Speaker, 2012 <http://www.futuristspeaker.com/2012/05/transforming-the-future-of-the-insurance-industry/>
Source: IBM, 2013 <http://www-935.ibm.com/services/us/gbs/thoughtleadership/big-data-insurance/>

CHANGING MARKETS

“Asia-Pacific will be the dominant driver of world insurance growth by 2020,” according to a study published by Munich Re’s Economic Research Department. Five of the expected global top 10 primary-insurance growth markets will be in the Asia-Pacific region, both in property/casualty (P/C) and in life^x. While global shifts are clearly occurring, there remains doubt over whether or not it foretells truly global markets.

According to a PwC report from 2012^{xi}, 30% of the industry believes new emerging market insurers will move into the developed world to become global insurers. Meanwhile, 28% foresee truly global markets. However, the impact of shifting global markets will impact incumbents. PwC’s Principal in Financial Services Marie Carr believes that “the rise of emerging markets is forcing insurers to re-think their current business models and go-to market strategies in these regions and countries^{xii}.” Demand and supply are fundamentally set to be rewritten.

However, emerging customer markets do not constitute all of the possibilities for insurers expanding their reach. Nigel Wilson, CEO of Legal & General, believes the insurance group has a role to bankroll a much-needed overhaul of Britain’s infrastructure. He believes that “in the next 10 years, it will be the insurers and pension funds that will be funding U.K. infrastructure investments, rather than the banks. We’ll see a transfer across, and I think that will be better for the economy. We’re in the socially-useful product area. Too much of banking was in the socially-useless area^{xiii}.” Other areas are opening up, too. Otto Thoresen, the ABI’s director general, expects the insurance industry to play an important role in developing solutions to help people fund their long-term care needs^{xiv}. Since 80% say insurers have a duty to contribute positively to society and only 55% agree they are doing that^{xv}, these new market opportunities also represent a way to reposition the industry in the emerging social era.

“As the risk landscape evolves ... organizations need to build resilience against the unpredictable.”

Joe Plumeri, CEO, Willis

x Source: Insurance Journal, 2013 <http://www.insurancejournal.com/news/international/2013/03/20/285193.htm>
xi Source: PwC, 2012 http://www.pwc.com/en_GX/gx/insurance/pdf/insurance-2020-turning-change-into-opportunity.pdf
xii Source: PwC, 2012 <http://www.pwc.com/us/en/press-releases/2012/2012-is-the-year-of-the-customer.jhtml>
xiii Source: Telegraph, 2014 <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/insurance/10219247/Insurers-will-soon-be-funding-UK-infrastructure-says-Legal-and-General-chief-Nigel-Wilson.html>
xiv Source: The Actuary 2014 <http://www.theactuary.com/news/2014/01/abi-and-ministers-agree-to-co-operate-on-long-term-care-insurance/>
xv Source: PRN Newswire, 2013 <http://www.prnewswire.com/news-releases/insurance-industry-faces-challenges-and-constraints-as-it-looks-to-the-future-according-to-new-study-by-bny-mellon-and-the-economist-intelligence-unit-190813591.html>

CHANGING MODELS, CHANGING NEEDS

Flipped models

There is a stream of thought that suggests current models will be inverted, and need to be inverted, if they are to keep with future developments. This would see them flip from a model yielding structured data to make tactical decisions and reacting to changes in the environment to one that actively uses unstructured data (alongside structured) to help inform long-term strategy in an attempt to craft a proactive or preventative model. Sophisticated artificial intelligence (A.I.) and big data may be able to provide insight on the most effective insurance solution for a given client, such as which emerging markets to enter, as well as when and how to proactively manage the customer experience to enhance retention of the most profitable customers. Insurers who are able to effectively utilize big data and advanced A.I., along the lines of IBM's Watson technology, could develop substantial competitive advantages.

Built on analytics

PwC says 49% of the industry expects new sources and techniques in the use of data analytics to be the key competitive differentiator^{xvi}. Mark Breeding, SMA Partner, suggests that “analytics hold great promise for the insurance industry, including the application of traditional business intelligence approaches, as well as advanced techniques such as predictive models and Big Data^{xvii}.” Data standards, such as those promoted by ACORD, will also be key in forming best practice and harmonization. Rather than being used as an auxiliary, it is important that analytics form a central part of management, the wider business model and the organizational culture. The use of analytics is nothing new within the industry^{xviii} – but the wider application, beyond underwriting and product design, is where both the challenge and opportunity lies. For example, an estimated 40% are already using analytics to develop advanced customer segmentation and another 20% are currently piloting or implementing. The need for a holistic data standard to help integrate the various insurance functions and back, middle and front offices are also critical, if data analytics is to become the central platform on which organizations run. For example, it has even been suggested that health “premiums might one day be conditional on patients’ use of personal monitoring, diagnostic devices^{xix}.”

“The majority of insurance companies perform 80% of their activities the same way their competitors do.”

Stuart Rose, Global Insurance Marketing Manager, SAS

Data modelling

One problem inherent in many organizations, both inside and outside the insurance industry, is when silos affect enterprise-wide data quality, completeness and utility. Concepts such as the “insurance data model,” have been proposed to help insurers rise to the challenge taking advantage of the data explosion. New data – via telematics, social media and geo-location – is so vast that many insurers have struggled to extract meaningful insight from it. In its broadest definition, a data model serves as a single version of the truth for an enterprise data warehouse covering all key insurance subject areas. Insurance Tech suggests that “despite the assertion that most insurance carriers claim that the way they do business is unique, due to regulations and general business practices, the majority of insurance companies perform 80% of their activities the same way their competitors do^{xx}.” Given that data is the lifeblood of insurance, efficient management and high data quality should now be viewed as an essential facet of the modern insurer, and those that do not leverage data effectively will be at a major competitive disadvantage. Indeed, regulations like Solvency II mandate specific requirements for data quality, and with that there is the possibility of providing greater process alignment with an organization.

“Risk managers and predictive modellers are going after different problems in some ways,” says David Cummings, Vice President and Chief Actuary of ISO Innovative Analytics. “However, there is an opportunity to marry enterprise risk management and predictive modelling together to produce new insights^{xxi}.” Mr. Cummings also suggests that the synthesis between analytics and risk management is contingent on investment in complementary technologies that improve the availability and quality of inter-organizational data flows.

xvi Source: PwC, 2012 <http://www.pwc.com/gx/en/insurance/pdf/insurance-2020-turning-change-into-opportunity.pdf>
xvii Source: Information Management, 2012 <http://www.information-management.com/news/insurance-analytics-business-model-strategy-meets-action-10022919-1.html>
xviii *ibid*
xix Source: WFS, 2013 <http://www.wfs.org/futurist/2013-issues-futurist/september-october-2013-vol-47-no-5/top-10-disappearing-futures/disap-4>
xx Source: Insurance Tech, 2011 <http://www.insurancetech.com/business-intelligence/adopting-an-insurance-data-model-for-a-s/231902436>
xxi Source: Business Insurance, 2012 <http://www.businessinsurance.com/article/20120923/NEWS06/309239996>

Mark Lewis, Global Insurance Industry General Manager at IBM^{xxii}, suggests that “the ACORD Framework models will give insurers a flexible set of industry-developed assets to help accelerate the global adoption of key industry concepts.”

40% of insurers are already using analytics to develop advanced customer segmentation.

Mark Breeding, SMA Partner

New operating models

Ninety-five percent of senior executives are not sure they have the right operating model for today’s world, let alone tomorrow’s^{xxiii}. Customer demand for a quick, responsive, and multichannel service is creating the need for a new analogue to the digital insurance operation model. Technology can enhance customer profiling, reduce costs and improve customer experience. It can also help industrialize routine underwriting, sharpen analytical capabilities and release talent to focus on high-growth markets and deal with more complex risks^{xxiv}. In many cases, however, this will involve business process outsourcing, which can place added emphasis on security and privacy of data.

New operating models underpinned by technology deployment options such as cloud, Software as a Service (SaaS) and Business Process as a Service (BPaaS) could reshape the industry as much as the rise in consumer power^{xxv}, yet a counter-current suggesting a recentralization of activities is also visible. “New regulations such as Solvency II are contributing to this change by requiring companies to demonstrate that they understand the models they use and the assumptions that are incorporated into them – something that has been difficult to do in the past given the ‘black box’ nature of these outsourced models^{xxvi}.” Accenture also notes that centralizing its operational model allowed one global insurer to cut costs by 20%^{xxvii}.

Real time modelling

With 1,000 average drivers on a UBI (usage-based insurance) program, an insurance carrier should be able to accommodate the transmission and storage of over 190 million data points^{xxviii}. Clearly, such volumes of data could enable a more closely tailored risk profile in real time. Insurance Tech highlights that “your utility company doesn’t bill you for electricity ahead of the month – they calculate your bill based on changes in your power use. Why shouldn’t this apply to auto insurance as well, where your insurance premium is calculated based on changes in your risk profile?” For example, a car sitting idle in a garage while the owner is on holiday or a business trip could benefit from a dynamic pricing scheme. Data concerning risk of theft, time of year and other risk factors for when the car is in use – such as weather, road condition, traffic – could also be factored in real-time dynamic weighting^{xxix}. It is likely that any successful trial could see such technology replicated in other insurance sectors, assuming the benefit to consumers is communicated effectively.

Access to multiple small models

Writing in Insurance Risk, Clive Davidson states that, “Understanding model uncertainty, managing the perils not captured in existing vendor models and providing model access to a wider community are three of the key challenges faced by the industry today^{xxx}.” A cross-industry collaboration is sponsoring the Oasis Loss Modelling Framework (LMF) that seeks to create a catastrophe modelling framework and an open platform for third-party catastrophe data, models and services.

Davidson writes that “at the centre of the Oasis LMF is a simulation engine and calculator that can take hazard and vulnerability models and exposure and insurance data from various sources and calculate potential losses. Around this simulation kernel, Oasis LMF provides an architecture for plugging in and integrating the models and data.” More open data platforms need not be confined to catastrophe, and opportunity for insurers exists in accessing several compilation style models.

How might modelling further evolve?

The use of predictive models can extend beyond ratemaking and inform other aspects of the insurance organization^{xxxi}. For example, predictive models could likely help underwriters work more efficiently. Predictive modelling could also help marketing by researching what mix of social media grows the customer base or what brand attributes drive new business, while the claims department could use it to analyze what claim typologies are increasing costs or to help identify possible fraudulent claims.

xxii Source: Information Management, 2009 http://www.information-management.com/news/data_model_application_architecture-10016485-1.html
xxiii Source: Accenture, 2013 http://insuranceblog.accenture.com/wp-content/uploads/2013/07/Running_Business_for_Growth_Accenture.pdf
xxiv Source: PwC, via The Digital Insurer Online, retrieved 2014 <http://www.the-digital-insurer.com/life-insurance-2020-competing-for-a-future-strategic-report-by-pwc/#sthash.g2jU2BwM.dpuf>
xxv Source: Insurance Networking, 2013 <http://www.insurancenetworking.com/blogs/future-of-insurance-innovation-transformational-growth-32430-1.html>
xxvi Source: Risk, 2013 <http://www.risk.net/insurance-risk/feature/2284594/cat-modelling-firms-open-platforms-as-insurers-demand-flexibility>
xxvii Source: Accenture, 2013 http://insuranceblog.accenture.com/wp-content/uploads/2013/07/Running_Business_for_Growth_Accenture.pdf
xxviii Source: Insurance Tech, 2013 <http://www.insurancetech.com/business-intelligence/the-big-data-approach-to-telematics-insu/240164351>
xxix Source: Insurance Tech, 2013 <http://www.insurancetech.com/business-intelligence/the-big-data-approach-to-telematics-insu/240164351>
xxx Source: Risk, 2013 <http://www.risk.net/insurance-risk/feature/2284594/cat-modelling-firms-open-platforms-as-insurers-demand-flexibility>
xxxi Source: Insurance Journal, 2012 <http://www.insurancejournal.com/news/national/2012/06/18/251957.htm>

TowersWatson^{xxxii} reports that “almost all (97%) U.S. personal lines respondents indicate they view sophisticated underwriting and risk selection as essential or very important. As a result, most U.S. personal lines insurers are already committed to predictive modelling; with approximately 85% of them saying they use or are planning to use it.”

Standard commercial lines insurers have been slower in recognizing its importance and moving to adopt predictive modelling, but are now starting to pick up the pace. In 2012, roughly 70% indicated they either currently used or planned to use it in underwriting and risk selection, and/or rating and pricing by the end of 2014.

There are also regulatory issues that could heavily influence data modelling. A BNP Paribas^{xxxiii} survey on firms’ progress on Solvency II requirements found that 57% reported a significant dependence on third-parties for risk modelling and other critical data requirements, while challenges in sourcing data of sufficient granularity for certain funds and products were also reported.

Key challenges identified in the survey include:

- Risk governance must be extended to include data and analytics provided by third parties
- 80% identified affiliated and third-party fund managers as key data dependencies
- Increasing requirements for risk modelling and securities services providers

The use of multiple models to get a spread of results is also emerging. For several insurance markets, a wide range of expertise is needed, including geographical, geological, meteorological, engineering, statistics, insurance and software development knowledge. Few companies can bring all these resources together^{xxxiv}.

“Model users are seeking to access a range of expertise beyond that which can be found in a single company^{xxxv},” notes Jane Toothill, director at JBA Risk Management. This suggests the possible use of multiple models to achieve a spread of results. That would increase complexity, but it might be a better hedge against systemic losses in the event of catastrophe, for example.

57% reported a significant dependence on third-parties for risk modelling.

BNP Paribas

Strategic technology use

Celent^{xxxvi} states that technology has changed the way insurers interact with customers. Evidence is amassing that suggests insurers are increasingly using it to help innovate services. Celent notes that for growth and retention, the key drivers for technological adoption and innovation include:

- Identification of new market opportunities and timely execution of strategy
- Identification of ways to increase the value of current customers and improve loyalty
- Identification of new ways to facilitate consumer-insurer communications

For risk and compliance, the key drivers for adoption and innovation include:

- Identification of new market opportunities and technology to exploit it. These technologies may include using cloud for business continuity or monitoring social media for reputational risk and big data.

For liability management, the key drivers for adoption were:

- Identification and application of claims data that improved actuarial tables and underwriting rules, identification and protection from fraud, and technology to support the identification of high-risk groups. These technologies include predictive modelling in claims and underwriting, social data in claims and underwriting, and advanced fraud analysis.

For efficiency and cost control, the report found that the key drivers for adoption were:

- Efficient interaction between call center agents with customers, intermediaries and other staff, process optimization and automation to reduce internal staff costs, and new technology delivery models to reduce the cost of deployment and maintenance. Virtualization, contact and customer management, business process management, cloud for core and noncore systems, HTML 5, sentiment analysis, and social and collaborative platforms are some of the key technologies. Critically, the technology used must align to the overall business strategy, the organizational culture must be receptive and willing to use the new technology and the technology should help improve both staff and customer experience.

xxxii Source: Towers Watson, 2012 <http://www.towerswatson.com/assets/pdf/6291/Towers-Watson-Predictive-Modeling-Insights.pdf>
xxxiii Source: The Actuary, 2012 <http://www.theactuary.com/news/2012/01/data-and-risk-modelling-top-insurers-solvency-ii-compliance-needs/>
xxxiv Source: Risk, 2013 <http://www.risk.net/insurance-risk/feature/2284594/cat-modelling-firms-open-platforms-as-insurers-demand-flexibility>
xxxv Source: Risk, 2013 <http://www.risk.net/insurance-risk/feature/2284594/cat-modelling-firms-open-platforms-as-insurers-demand-flexibility>
xxxvi Source: Benefits Pro, 2012 <http://www.benefitspro.com/2012/04/30/technology-changing-face-of-insurance-industry>

Digital demands

Some 60% of insurers lack a digital transformation strategy, and only 13% have totally integrated digital into their offerings^{xxxvii}. This is cause for concern, given insurance sold through digital channels could reach €25 billion annually in Europe alone as soon as 2016, more than double its 2012 value^{xxxviii}. Success in the digital arena requires a comprehensive approach that engages customers seamlessly across all channels (omnichannel) - both online and offline - and on their own terms.

A new era of partnerships

Four-fifths of insurers say that their businesses will have to change to produce adequate shareholder returns over the next three years (EIU, 2013)^{xxxix}. Thirty percent of respondents to the same EIU study predict large-scale change for the insurance industry over the next three years, driven by the low-yield environment and restrictive regulation.

An Accenture study (2013) also indicates that nearly nine European insurers out of 10 (89%) are expecting competition to intensify in the insurance distribution market over the next three years. Almost two-thirds (64%) believe that this competition will come from non-insurance players, such as Google, or e-commerce giants like Amazon^{xl}.

SwissRE suggests that with the current (and future) levels of complexity, traditional approaches don't always work, and that "you have to convince existing institutions to collaborate." SwissRe took a collaborative approach to the understanding of climate change and resilience by partnering with the Global Environmental Facility (a UN body), the European Commission, the Climate Works Foundation, the Rockefeller Foundation, and then like-minded companies like Standard Chartered Bank and McKinsey. The resultant methodology "helps decision makers in regional and national economies think about climate-related costs, investment options, and how the costs and benefits weigh out. It goes from prevention, to intervention, to risk transfer as instruments."

- Take, for example, increasing climate resilience for the city of Hull, in the U.K. First, SwissRe looked at the most relevant hazards and analyzed historic disaster data — wind, inland flood, storm surge, etc.
- Then they used probabilistic modelling to estimate the magnitude of expected economic loss.
- SwissRe then estimated the expected economic loss today, the incremental increase from economic growth, and then any further incremental increase due to climate change. Climate change risk is the most difficult to predict, so they used three different scenarios: today's climate, moderate climate change, and extreme climate change running out to 2030. In the case of Hull, using the high climate change scenario, the expected losses from exposure to climate increased 71%, to about \$90 million annually on average. Different adaptation projects were then assessed, from reinforcing sea defenses to retrofitting buildings and changing codes for new buildings. 65% of the predicted loss for Hull under the high climate change scenario could be cost-effectively averted by prevention and intervention measures^{xli}.

xxxvii Source: Insurance Blog (Accenture) 2013 http://insuranceblog.accenture.com/wanted-holistic-strategy-for-digital-transformation-3-of-4/?cid=fs_insblogfy14_10000105_smc_0913#sf18765237

xxxviii Source: Accenture, 2013 http://newsroom.accenture.com/news/insurance-sold-through-digital-channels-to-reach-25-billion-annually-in-europe-according-to-accenture-study.htm?c=glb_accglbtwt_10000945&n=smc_0713#sf18286796

xxxix Source: Blackrock (EIU), 2013 <https://www.blackrock.com/institutions/en-axj/literature/market-commentary/eiu-global-insurance-research-sept-2013.pdf>

xl Source: Accenture, 2013 http://newsroom.accenture.com/news/insurance-sold-through-digital-channels-to-reach-25-billion-annually-in-europe-according-to-accenture-study.htm?c=glb_accglbtwt_10000945&n=smc_0713#sf18286796

xli Source: MIT Sloan Management Review, 2013 <http://sloanreview.mit.edu/article/insuring-a-better-future-sustainability-at-swiss-re/>

DISRUPTIVE CHANGE

While technological, social and regulatory change undoubtedly represent opportunities for insurers, it would be unwise to dismiss the scale of the impact they could have on the business-as-usual scenario for the insurance industry. Some types of insurance could disappear or be developed along social lines and insurers could even find themselves sidelined by fast-moving, more data-rich organizations. Given the same drivers are in play across many financial services, such possibilities should be heeded by insurers.

“We fundamentally recognize that the future of financial services lies with entrepreneurs.”

Derek White, CDO, Barclays

There are already signs pointing to an alternative future. In Germany, Friendsurance is a website that is now considered the pioneer of “social” or “person-to-person” insurance. The idea is to more efficiently replicate for a group of friends what traditional insurance companies do for a large number of strangers. As an intermediary for actual insurers, it offers household, personal-liability and legal-expenses insurance^{xlii}. Some analysts, such as Dave Aron of Gartner, believe that “insuring in self-selecting groups can improve the quality of the risk^{xliii}.” It may also lower the cost. The website, now in its fourth year, says premiums are typically 50% below what other companies charge^{xliiv}. It also claims that it passes on 20% to 40% fewer claims than other companies. Although it will not give an exact number, take-up is said to be in the solid five figure range^{xliiv}. Fast Company also notes that “it might also be possible to go further than Friendsurance and set up a wholly-peer-based system (with no outside insurer). That’s what Peercover, a U.S. start-up that launched in September, is doing.”

If we consider that the core competency of all insurers is to aggregate, predict and manage financial risk, then it stands to reason that organizations possessing the same core competency are potential rivals, no matter their industry segment. Data analytics form the basis of both Google’s and Amazon’s business models, and it is increasingly likely that other industry ecosystems (hospitals within the health insurance landscape for example) will be able to develop or procure the ability to predict and manage such risk^{xliiv}. Google for example, has already made several moves that suggest it could be moving towards the insurance market. It’s applying the Internet of Things to human health through developing glucose-measuring contact lenses, and it’s moved in the space of remote sensing and control of residential and commercial environments through the acquisition of Nest, giving it significant opportunities for enhanced risk mitigation and pricing. Indeed, the ubiquity of smartphones and sensors tied to cloud computing will allow extensive home health screening – and as a result, “insurance premiums might one day be conditional on patients’ use of personal monitoring, diagnostic devices^{xlvii}”.

Perhaps even more significant moves can be found within the auto insurance segment. Google has acquired auto insurance aggregators, launched price comparison sites, founded an alliance to promote a standard platform of in-car computing and also pioneered the driverless car^{xlviii}. Since the goal of the driverless car is to reduce accidents, analysts note that it’s plausible that “property/casualty insurers see a major reduction in their auto insurance premiums revenue^{xlix}.” By some estimates, 90% of drivers would consider an autonomous car if it cut insurance rates^l. As noted in paper two of this series, some enterprising insurers such as Tokio Marine have developed a smartphone app designed to warn of possible accidents and to establish culpability in the event of a crash^{li}. The future of the industry will be in part decided by where moves like this overlap with efforts from outsiders, and who is able to better scale and provide consumer value.

Against this backdrop of expanding data capabilities and social tools, insurance companies are ostensibly abandoning certain areas (guaranteed products could be abandoned by many), while four-fifths of insurers say their businesses have to change to produce adequate shareholder returns over the next three years^{lii}.

Regulatory change is forecast to stop nearly two-thirds of insurers from writing certain lines of business.

Economist Insights

- xlii Source: Economist, 2012 <http://www.economist.com/blogs/schumpeter/2012/06/peer-peer-insurance>
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POTENTIAL IMPACT

As a consequence of global economic trends, insurance will become less attractive as an industry for investors than it was in past decades, Accenture predicts. It says that insurers failing to respond effectively to the new normal can expect, at best, a return on equity of 5% to 10%^{liii}.

Personal lines

- Greater commoditization: Price transparency, disintermediated direct purchase and virtual social community-led bulk purchase could all lead to greater commoditization of personal lines insurance. At the same time, and somewhat paradoxically, complexity will intensify with increased demands for personalization.
- Decreasing profitability: The increased number of growing megacities being built in areas prone to natural disaster could result in catastrophic losses if potential risk is not adequately priced into products. Conversely, the number of global consumers entering the middle class looks set to bolster the number of insured actors.
- Predictive rather than reactive: It is possible that advances in advanced early warning systems, coupled with innovative risk-sharing methods, could help reduce losses from natural disasters and other catastrophic events.
- Automated underwriting: Aging human resources in the developed world and lack of underwriting skills in emerging markets could lead to severe talent shortages. It is unlikely in the short to mid-term that there will be enough qualified underwriters to simultaneously satisfy demand from both emerging and mature markets. Global talent sourcing strategies may help in some cases, but automation is likely to provide an alternative option.
- Technology becomes standard, not the differentiator: It is likely that insurers will use telematics and other emerging “real-time data” technologies, initially for car insurance. However, in the medium term and as the technologies evolve and public acceptance grows, the potential use of telematics in areas as diffuse as risk management and controlling losses will become possible. We will then see technology move from the operational to the strategic which, the very best exempted, could lessen the competitive advantage of using such technologies in standard ways.
- Gartner estimates that by the end of 2015, personal lines property and casualty (P&C) insurers that do not offer online and mobile transactions will lose one-quarter of their current market share. Gartner also estimates that more than two-thirds of global life and P&C insurers still rely on legacy systems (some dating to the 1970s or '80s) to a significant degree to manage their core processes^{liv}.

Commercial lines

- Going social: Social networking among small business owners could create virtual business affinity groups that pool their risks and retain more predictable layers of risk. With trust between friends routinely higher than public trust in financial services, situations where direct buying, or even self-insurance, proliferates are not impossible to imagine. This could result in a profound examination of the role of advice and the role of distributors as sales channels.
- Automated underwriting: 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 the emerging Internet of Things will continue to transform the commercial insurance business model. It is possible that this will lead to a decrease in proprietary products, a rise in standardized products and a focus by insurers on where in the value chain they can add value to the customer.
- Increasing complexity: Risks, given all of their global and system interdependencies, are becoming more complex. Without the systems or analytical talent in place, there is clearly a threat that insurers simply won't be prepared with contingency plans for adverse future outcomes. However, there is an opportunity to radically reshape the business model around data and analytics in order to develop a proactive business model and possibly even new risk transfer markets and methods.
- Product plus: Given the low short- to mid-term prospects of growth in many mature economies, insurers have a decision to make regarding future revenue streams. Emerging market exploration is almost certainly one possibility, but adding value for customers in western economies may also be fruitful. For example, with governments and organizations in many mature economies focusing on preventing further erosion of their capital base rather than seeking new growth strategies, creating value-adding services around risk management and loss control may be feasible.

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Source: Accenture, 2011 <http://www.accenture.com/us-en/blogs/accenture-blog-on-insurance/Media/High-Performance-Insurer-of-the-Future.pdf>
Source: Bain, 2013 <http://www.bain.com/publications/articles/for-insurance-companies-the-day-of-digital-reckoning.aspx>

Brokers

- Radical change: Former Aon Global chairman and Aon Ltd CEO and chairman Dennis Mahoney proposes a radical vision of intermediaries' future, which includes:
 - All information flowing directly from buyer to seller.
 - All fiduciary funds, premiums, claims, etc. flowing directly between buyer and seller.
 - The end of commissions.
- Evolution of role: Disintermediation in many ways is the future for brokers, but it is about transformation, not extinction. High street retail was not killed by the Internet, but has instead evolved. Insurance is, for now, in the domain of tailored products, of negotiation and judgment – and for now these value-adding capabilities remain in the human, as opposed to technological, domain. Brokers can help provide context for what promises to be an overwhelming amount of data for consumers to access, which further stresses the need for players to create a strong technological backbone to their operations.
- Reconfigured market: Access to Lloyd's is not always understood by brokers, yet Lloyd's will be a broker market in 2025, says Lloyd's Chairman John Nelson. He hopes "to see a situation where brokers are extending their networks, picking up new business across the world and placing it at Lloyd's."
- Innovative offerings: Brokers will increasingly offer value-adding services, either through partnering with others or developing the capability in house. Alan & Thomas Insurance Group partnered with Aviva Risk Management Solutions to offer commercial clients free access to risk management tools and services. The online services include risk management help and advice, access to Aviva experts and discounted rates for training and consultancy services. The broker's clients have unlimited access to 200 free legal and business guides, and topics include environmental management and employment, and occupational health and property protection via Aviva's knowledge store^{lvii}.
- Dislocation: Regulatory reform is ostensibly high on the U.K. and European agenda. In 2012, Tidjiane Thiam, the chief executive of Prudential noted that the Solvency II regulation – due to be introduced in 2016 – will hamper the company outside the EU, where the Pru makes 88% of its profits. The company has stated that it would be forced to leave London under such circumstances, which could cause potential dislocation of the ecosystem of other organizations that are in some way connected to Prudential, especially if their prediction that their leaving would be like a "dam breaking."
- An Insurance Times poll on the future of brokering, suggests that^{lviii}:
 - Community brokers will be extinct in 5 years.
 - disagree (84%) agree (16%)
 - Brokers must embrace e-trading to survive.
 - agree (82%) disagree (18%)
- Technological advances are likely to mean that insurers, brokers and clients will get along much better. Lark Insurance's chief executive, Stephen Lark, says, "I think there has to be definite improvement between system connectivity between insurers and brokers. There are attempts made to improve it, but there is still a lot of keying and double keying^{lix}."

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Source: Insurance Insider, October 2011 <http://www.insuranceinsider.com/-1235653/42>

Source: Property Casualty, 2012 <http://www.propertycasualty360.com/2012/05/21/lloyds-of-london-unveils-strategy-for-future-grow>

Source: Insurance Age, 2012 <http://www.insuranceage.co.uk/insurance-age/news/2206517/broker-in-aviva-deal-to-offer-free-risk-management-service>

Source: Insurance Times, 2013 <http://www.insurancetimes.co.uk/home/debates/future-of-brokering/>

Source: Insurance Times, 2010 http://www.insurancetimes.co.uk/Journals/Newsquest/Insurance_Times/E-Brokering_22_July_2010/attachments/EBrokering_Jul10.pdf

RESPONSES

A range of possible responses exist to the challenge to change. Although not mutually exclusive and allowing for a degree of mixing between the descriptions, we highlight four of them below.

First to the Future

Insurers that are aiming to be first to the future will seek growth through a range of innovative products and services. These insurers will leverage their inherent capabilities to either penetrate new markets, better segment existing markets or reach out to customers in new and unobtrusive ways. Adding value and redefining their traditional role through innovative front office offerings is key to this approach.

Early adopters

Although not necessarily the first to implement new processes or methods, these carriers' strengths lie in adaptive market intelligence and a horizon-scanning capability that allows them to sense opportunities and assess others' efforts before the mainstream does. Flexibility and aligned back office data is essential to develop new directions and goals on the go. Early adopters often refine imperfect implementations observed elsewhere and help define the product or service in question.

Supertankers

These carriers do not have the flexibility or culture to successfully adapt quickly to change. The result is that they are often among the last to implement new tools and business processes. It is vital that such organizations develop a robust middle office and are operationally resilient if they are to succeed in the marketplace.

Hybrids

Given the range of possibilities open to insurers, it is quite possible that many will develop specialties not replicated elsewhere in the industry. It is possible for example, that an insurer with only minimal advantage derived from big data analytics will be quite adept at using new channels to reach customers. Under this scenario, carriers develop specific skill sets that they market internally within the industry and develop mutually beneficial partnerships with other players – from both inside and outside the industry.

CRITICAL FUTURE SUCCESS FACTORS

Tomorrow's successful insurer could be built on comparative advantages in any one area, or a combination of different areas such as:

- Internal data management: The use of standardized data models, standardized toolsets and points of access from which the range of business capabilities can be accessed will be critical in allowing the carrier to reassess and act on the very latest emerging trends and insights. Data is the new oil, and new structures must reflect that.
- In order for big data to be a successful base from which to base operational, revenue and enterprise models, more prosaic forms of data must be in order. This is something that insurers are still struggling to keep accurate. According to a 2012 Experian QAS study, 92% of organizations suspect their customer and prospect data might have inaccuracies. On average, respondents suspect that as much as 25% of information is inaccurate^{ix}. For many legacy insurers, this may be more of a logistical challenge than for new or emerging insurers, who may be able to scale these issues more effectively.
- Inherent agility: The need for continuous innovation, to reduce organizational complexity and provide the consumer of tomorrow with timely and on-demand solutions, will require insurers to develop demonstrable organizational agility.
- Innovate risk transfer/sharing: The need for new models to help counter potentially more frequent and costly natural disasters is pressing. For example, greater use of multiple trigger insurance policies may develop that seek to provide protection against an accumulation of uncorrelated events, including climate risks^{ixi}.
- Target success: Carriers need to make deliberate and clearly thought through choices on how they will pursue growth and where they expect it to originate and then tailor the business model and internal technological and cultural ecosystem to help pursue their chosen strategy. Given declining profitability prospects and the global war for talent, change will need to be holistic for even the highest performing of modern day insurers.
- Standards become critical platforms and enablers: There is a need for standards at data, process and infrastructure levels. This will help ensure that insurers can interconnect with rapidly increasing external information sources, new markets and players, with and across new technologies. It's clear that this is a strategic issue, not a tactical issue. It is a business issue, not just an IT issue, and one where competitive advantage, even survival, is at stake. This is an issue for the CEO, CMO, CFO, CHRO, CPO as well as the CIO and CT.
- New delivery routes: Achieving the correct balance of outsourced and centralized operations will prove critical for insurers to meet the triple bottom line of regulatory compliance, analytical capability and superior customer offerings. Innovation capability is also inherently linked to these issues. Two technology-driven channels – social media and mobility – are emerging strongly and present new technical and resource challenges. New delivery models – for example those that include a marketing/sales solution integrated into a business process outsourcing model will feature.

“Typically, insurance companies spend between 50% and 70% of their IT budget on simply running the business.”

Gartner

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Source: Insurance Tech Asia, 2013 <http://www.insurancetech.com/business-intelligence/whats-the-big-deal-about-big-data/240007782>
Source: Innovation Group, 2012 <http://www.innovation-group.com/us/pressreleases?pressreleaseid=429>

SUMMARY

The risks of inaction in insurance are as strong as the opportunities for growth. A reliance on traditional insurance models is creating exposure to changing risk profiles. A new era of strategic technology and organizational change is needed to adapt and thrive in these new conditions. Insurers need to make clear and deliberate choices about where their growth will come from, and, Accenture notes, “align their operating model, governance and capabilities to their chosen business model^{lxii}.” Closer relationships with third parties will be needed in order to source the support required to augment core competencies – both technologically and organizationally.

Trusted partners and ecosystem development will be vital in crafting data modelling strategies that satisfy compliance needs, enable volumes of data to be analyzed for insight and deliver a better customer experience. New, innovative delivery and pricing models based on real-time data and/or more granular groupings may enable insurers to better correlate costs with business volumes and ultimately allow insurers to invest capital into other strategic or growth initiatives^{lxiii}.

lxii Source: Accenture, 2011 <http://www.accenture.com/us-en/blogs/accenture-blog-on-insurance/Media/High-Performance-Insurer-of-the-Future.pdf>
lxiii Source: Innovation Group, cited in Yahoo Finance, May 2012 <http://finance.yahoo.com/news/future-insurance-initiative-launched-innovation-151500560.html>

KEY QUESTIONS

1. What is our approach to data modelling? Is it strong enough to base our business around, and do we have the correct infrastructure in place to use it effectively throughout the organization?
2. Are we prepared for shifting business foundations and are we agile enough to incorporate change into our business model?
3. Who, or what, do we see as our main competitors or competitive challenges? How can we adapt or even use these challenges into our advantage?



EQUINIX

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About ACORD^{lxv}

ACORD (Association for Cooperative Operations Research and Development) is a global, nonprofit standards development organization serving the insurance industry and related financial services industries. ACORD's mission is to facilitate the development of open consensus data standards and standard forms. ACORD members include hundreds of insurance and reinsurance companies, agents and brokers, software providers, and industry associations worldwide. ACORD works with these organizations towards a goal of improved data communication across diverse platforms through implementation of standards. ACORD maintains offices in New York and London.

ACORD is a member-driven organization whose members work together to improve the flow of insurance information between systems and partners. ACORD Standards and services improve data quality and transparency, resulting in greater efficiency and expanded market reach.

Learn more at www.acord.org



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