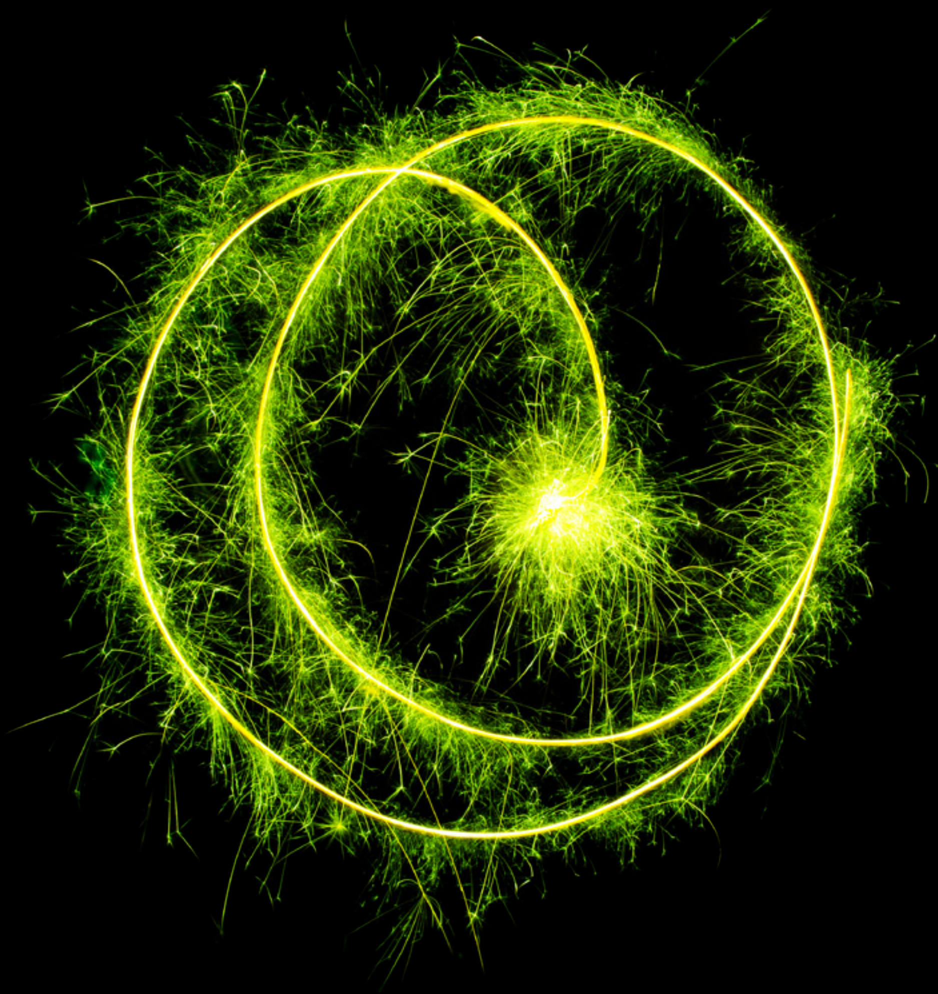

A catalyst for change

How fintech has sparked a revolution in insurance

Dear colleagues,

Frictionless sales and service. Simpler, more transparent products. Greater choice and flexibility. A more scalable operating model.

The customer-centric culture, disruptor of so many other industries, has arrived for insurance. At the vanguard? InsurTech, which is showing customers the "art of the possible" now.

Already, hundreds of companies have appeared on the global insurance scene. They're using technology to remove friction and transform the customer experience. They've managed to do this by:

- Carefully watching, listening to, and learning from customers
- Bringing concepts from other industries to bear
- Challenging long-held assumptions about insurance
- Asking the question, "Why not?"

Many more companies like these are on the way.

By and large, InsurTechs are nimble and adaptive businesses. They have digital-first, cost-efficient structures, and in some instances have tapped into a zeitgeist of younger customers rejecting bigger corporates.

For all these reasons, InsurTechs offer incumbent institutions more than just challenge and provocation. They also present opportunities for partnership and collaboration—even ownership, provided firms have the ability to preserve their new acquisition's benefits.

At the same time, carriers face a high degree of unintentional disruption from other industries. These adjacent developments are the result of the changing nature of competition in other industries—mobility, the connected home, genomics, and industrial manufacturing to name a few. In many cases, these introduce new characteristics of risk. They also introduce new business models that challenge elements of the insurance value chain while influencing client needs, expectations, and preferences.

However it plays out, I remain highly encouraged by the potential for digital technology to bring an exciting new era of customer-centricity to the venerable world of insurance.

Sincerely,

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How fintech sparked a revolution in insurance

It's a moment of truth for insurance. Despite a long period of relative stability in the industry and continued overall strengthening of surplus capital, sustainable, profitable growth has been elusive for the majority of carriers. Where we have seen growth it has come largely as a result of taking market share from competitors or in the more emerging markets. More often than not, this growth has come at a cost.

The challenge—or indeed opportunity—of the coverage gap remains, largely absent of any real improvement. The promise of new business models to attract the under and uninsured remains unfulfilled. Too many customers remain challenging to insure due to prevailing product and cost structures. The need for product simplification is well-acknowledged, as is the need to pivot to insurance based on what customers want (versus what carriers believe they can sell). That said, genuine progress has been anemic.

None of this is new, but this time it is different. Advancing technology has collided with longstanding customer issues to create, what we believe to be, a series of deep, lasting, systemic challenges for insurance.

In the discussion that follows, we'll take a closer look at the conditions bringing customer needs and expectations to the fore. We will also examine the disruptive forces behind those conditions, and what they could mean for insurance companies. But before we do all that, let's review the structural impediments that are slowing insurers' response to this environment—and leaving the door open to ambitious competitors.

An industry at a crossroads

Insurance is not something people love to buy. Acquiring it forces customers to confront challenging realities. Keeping it requires an outlay of cash, often with little in return but a hedge against an uncertain future. Of course, that hedge has significant value but keeping that top-of-mind has proven challenging for an industry that has mostly operated on a product-centric rather than customer-centric mode.

Still, given the nature of the product, you would think the industry would be throwing everything possible at attracting customers to buy and hold their insurance. Yet so often we do the opposite. Customers often must run through a gauntlet of invasive financial and/or medical data-gathering before they can know what the product covers, how much it costs, or whether they can even buy it at all. The arcana of product detail remains challenging to decode. Our products are still often based on what insurers can produce rather than on what customers need and prefer. And the majority of processes are tough to appreciate.

This situation is increasingly at odds with customer expectations today. Human-centric design has conditioned consumers to expect harmony and simplicity in their products and service interactions. Even complex products are available online, allowing shoppers to compare alternatives—maybe not like-for-like, but close enough—and go on to complete a purchase in a simple and trusted fashion. Technology startups have taken these examples and brought them into the insurance realm, showing customers the "art of the possible" through innovations such as on-the-spot purchasing and claims processing. (More on that later.)

The upshot? For insurers, "have it your way" is increasingly becoming the byword for growth. Consumers, with all their complexity and nuance, are in the pilot's seat.

Less room to maneuver

This friction has proved costly to the industry. In more developed markets, aggregate growth has been anemic across most lines of business. Among individual insurers, growth has come not from an expanding market but from taking market share, often with an impact on the bottom line. In some cases, real insurance penetration has in fact been decreasing. Consumers are questioning the relevancy of certain products, particularly those they're not required to purchase by law. Rate competition is constant in many lines and many markets. At the same time, costs for marketing and distribution continue to creep upward.

In more emerging markets, where certain lines of business have been attractive beacons of growth, attractive profitability has been challenging. And often the ability to continue to fuel that growth—to build greater economies of scale—is impeded by cost, inefficiency, and limits to scalability. This can be as true for traditional distribution as it is for bancassurance models.

It's time for something new. When traditional business and operating models stop delivering sought-after results, the logical next step is to of course explore alternatives with greater voracity and risk appetite. In other words, the industry should disrupt itself before a newcomer does it for us.

The art of the possible—now

Where customer friction and untapped profit potential meet, disruption is bound to appear. Hundreds of InsurTechs have appeared on the global insurance scene over the past few years, and many others are on their way. All are using technology and customer-centric approaches borrowed from other industries to address pain points, opening a window onto a transformed customer experience. Across the field of InsurTech, customers now can find, among other things:

Seamless engagement. Customers are exposed to rigid rules of engagement for purchasing and claims. In response, Vantis Life developed a platform to underwrite life insurance based on public records and third-party data providers, removing the need for many customers to undergo medical tests.[1] And In early 2017, home insurer Lemonade reported that its AI-powered technology processed and settled a theft claim in just three seconds, without paperwork from the customer.[2]

Usage-based insurance. Rather than be locked into longer-term coverage, customers are demanding coverage they can toggle on or off at will to cover periodic situations or behaviors. For instance, San Francisco-based Trov provides a mobile app that lets users activate and deactivate insurance across an inventory of their belongings.[3] Metromile offers pay-per-mile insurance for city dwellers who drive only occasionally.[4] Cuvva lets you borrow your friend's car, while Car and Away and Forest Car let you rent yours out while on holiday. [5, 6, 7]

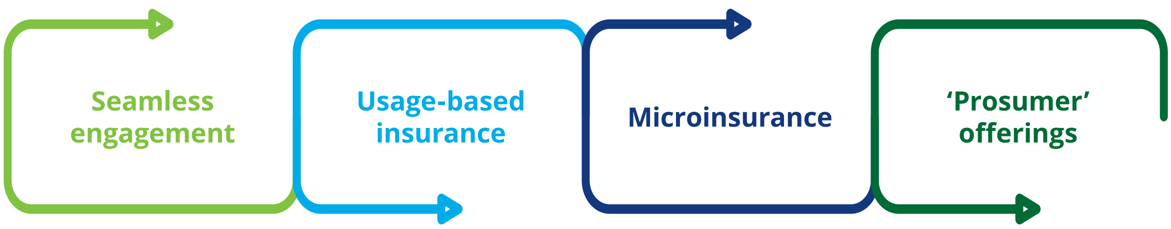
Microinsurance. InsurTech companies are offering insurance tailored to the needs of ever-narrower consumer segments. London-based Bought by Many, for instance, created a way for customers to sidestep traditional routes so they can purchase niche products insurers won't often touch, such as travel insurance for customers with known medical conditions (e.g., cancer survivors).[8] Meanwhile, an initial rollout of a product to protect against frozen pipe leaks in low-occupancy buildings—the result of a partnership between Church Mutual and another insurer—saved close to US$1 million in claims across 1,500 houses of worship.[9]

'Prosumer' offerings. As the line between personal and commercial use blurs, consumers increasingly need coverages that specifically address what they're doing with their property. For example, online hospitality platform Airbnb set up an insurance program that provides homeowners with primary coverage for bodily injury or property damage related to an Airbnb stay.[10]

As these examples show, the global InsurTech market is abuzz with innovative startups that aim to address a range of unmet needs and friction points among consumers. By nature, these startups are nimble and adaptive. Many pose compelling challenges to parts of the traditional insurance value chain. Others offer interesting opportunities to accelerate change and transform the customer and digital capabilities of incumbent insurers—provided the latter refine their ability to engage with new enterprises in a meaningful way. For most insurers, this is a significant undertaking.

It's worth noting that not all InsurTechs started with insurance in mind. Some set out with a more generalized offering only to discover attractive use cases for insurance. Australian startup Flamingo AI, for instance, launched in 2016 as a provider of technology to guide online customers in their selection and purchase of financial products. Since that time, the company has inked a deal with Liberty Mutual to test a version of Flamingo's cognitive virtual assistant platform for auto insurance quotes. It's one of a series of moves aimed at boosting sales and revenue for the startup.[11]

The art of the possible—now



Accidental disruption

Incumbent insurers face a high degree of unintentional disruption from other industries. These developments tend to change the nature of risk or introduce new characteristics of risk that might not have existed in the recent past. They also introduce new business models that challenge elements of the insurance value chain while influencing client needs, expectations, and preferences. Examples include:

- **Industry 4.0:** Manufacturer processes and systems are being transformed with the introduction of technologies such as AI and augmented reality. This changes the nature of risk in the manufacturing space, with corresponding implications for the commercial insurance markets.[12]
- **The future of mobility:** This category includes automotive technology, connected cars, and semi- or fully-autonomous vehicles. It also includes go-to-market models such as subscription programs, car sharing, and ride hailing. Whatever the innovation, be it technology or business model, the automotive and transportation industries are pouring billions a year into it. The implications for insurance are profound.[13]
- **Genomics:** In life sciences, genomics—the decoding of a patient's personal biology—is creating more effective ways to identify, predict, treat, and manage diseases. Gene splicing technology such as CRISPR Cas9 creates even more challenge to the future use case for life insurance business lines.[14] All these developments have a significant influence on longevity and ways to underwrite life insurance in the near future.
- **Wellness:** Lifestyle factors help to determine risks covered by life- and disability-related insurances—and play an increasingly significant role in underwriting versus traditional mortality and morbidly tables. The rise of wearable technologies, along with continued growth and development in wellness, is altering consumer understanding and creating new models for lifestyle-related behaviors.
- **Connected home:** Smart devices are becoming more pervasive in the home. Meanwhile, competition is intensifying to own the hub or platform that connects these devices. The future effects on insurance needs, and the related opportunities and threats, are an open question.

All of these examples have implications for insurance, including:

- Product development opportunities
- Challenges for pricing and underwriting risks
- New business models that could further disintermediate the insurer
- The chance to deepen relationships with consumers
- Uncertainty around competitive dynamics in the not-too-distant future

One certainty? It will take significant leadership attention and innovation capacity to prepare the insurance enterprise for these rapidly evolving developments.

The digital cascade

The same technological shifts affecting the front-end of the insurance value chain—that is, customer engagement and acquisition—are cascading through the operating model. This points to digital transformation as a way to provide sustainable, scalable outcomes along with the flexibility and adaptiveness needed to achieve them.

Advanced technologies—blockchain, cognitive intelligence, and next-generation robotic process automation among them—provide ample tools to transform the back and middle offices. For instance, Japanese insurer Fukoku Mutual implemented an IBM Watson-based system that can read unstructured data such as medical records and interpreting it to calculate insurance claims.[15] Meanwhile, Paris-based Shift Technology's machine learning algorithms surface suspicious claims from large datasets, improving their own accuracy over time.[16]

Ultimately, insurers that master these technologies—and the ability to successfully incorporate them throughout the enterprise—will gain the core capabilities they need to adapt to the rapidly-changing environment of customer needs and preferences, not to mention the changing nature of risk.

But this isn't just a technology journey. It's also a matter of managing complex change and internal disruption, such as the inherent workforce complexity resulting from the changing mix of human and "robotized" interaction across the insurance value-chain.[17] This involves resolving questions around how to create more effective partnerships (with InsurTechs, for example) and more adept integrations with new platforms.

Another important aspect of the InsurTech movement is the degree of cooperation between insurer and startup. Incumbents continue to have a hand in the solutions technologists have sought to provide. Bought by Many, for instance, is backed by reinsurance giant Munich Re. Vantis Life is a subsidiary of the Penn Mutual life insurance company. For its part, New York-based CoverWallet is working with Zurich Insurance to provide a digital platform aimed at helping customers find coverage in minutes.[18]

Traditional insurers offer capital, market reach, brand recognition, regulatory support and access, and infrastructure. In return, InsurTechs provide fast, innovative responses to market dynamics. The result is a restructuring of the traditional insurance value chain into an interconnected community that's more modular, more flexible, and more attuned to the customers' specific needs.

Looking ahead

These many developments point to a common conclusion: turbulence is upon us. Where will it take the industry? Here are four possible scenarios.

Changing the channel. InsurTechs (with the support of insurers and reinsurers) win more of the insurance market by focusing on benefits to their customers, including superior processes for onboarding and claims. Incumbent insurers respond with simpler purchase processes and more customizable products. Partnerships with product makers and distributors become more popular as insurance providers seek to capture customers at the point of sale. Many insurances are built into goods and services—or embedded into an overall end-to-end proposition—enabling customers to focus on selecting the products that best fit their work and lifestyle. This prompts insurers to rethink the importance of brand, advertising, and agents (particularly captive agents) in their go-to-market strategies.

Underwriting by machine. Insurance becomes more dependent on sophisticated algorithms, relying on new source forms of data, in order to compete. Risk selection is more individualized, with products becoming available at a wider range of price points thanks to new data and greater pricing sophistication. In a bid to keep up with fast-developing AI innovations, firms outsource their underwriting to specialist technology vendors. And with underwriting no longer a differentiator, some firms focus on customer service and scale while others pursue niches such as affinity products.

Rise of the flexible product. As more customers hire out their personal property and earn wages from multiple sources, insurers must connect their business and personal lines. Meanwhile, insurers get better at measuring and tracking usage of the products that customers want insured. The result? Time-flexible, event-driven coverage that can be turned on or off at will. At the same time, a truly modular and adjustable product evolves to accommodate life stage, lifestyle, and wellness changes among consumers. The result? Frictionless insurance in a land of utility, centered on the customer and their needs at different times in their life rather than on traditional insurance product silos.

E-Z life insurance. Life insurance firms see growth in emerging markets with a younger, lower-income customer base. Leading insurers match the needs of these customers with short-term, flexible term products. Given the shopping patterns in many emerging markets, firms that can master digital distribution without compromising underwriting break away from those that remain dependent on field sales agents. Because of these shifts, life insurers end up looking more like general insurers, fostering industry consolidation.

However the disruptive forces of innovation play out, we can count on a few things:

- New technology is modularizing the insurance value chain
- Customers are seeking complex, highly personalized products
- Fintech companies are raising expectations for a frictionless customer experience
- Growing connectivity points to a foundational shift from risk assessment to risk prevention.

The insurers who embrace this disruption and reorient themselves to a newly-assertive customer will be the ones finding routes to long-term profitability and growth.

Possible futures

	Changing the channel	Underwriting by machine	Rise of the flexible product	E-Z life insurance
General	✓	✓	✓	○
Life	○	✓	✓	✓

Changing the channel

- Insurers improve their customer-facing digital experiences
- Insurance becomes more integrated with products
- Consumers benefit from products tailored to their needs
- Advertising for mindshare becomes less important

Underwriting by machine

- Underwriting becomes more complicated and dependent on AI
- Third-party underwriting (for AI expertise) becomes the industry standard
- Insurers create two different paths for customers
- Insurers fight to differentiate themselves

Rise of the flexible product

- Insurers link business and personal insurance for the sharing economy
- Insurers use technology to enable time flexibility
- Insurers engage with consumers to monitor coverage
- Customers may be surprised by inconsistent coverage

E-Z life insurance

- Insurers develop digital channels for product distribution
- Term products become more popular
- Life insurers deprioritize agents and investments
- Life insurers increasingly resemble general insurance firms

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