NEW FACES, NEW TRICKS

InsurTech gathers pace as established providers examine options
Unease stems from a variety of gradual, but accelerating and interlinked developments. Much has been made of the technological changes effecting the way in which customers now access products and services and the behavioral shifts these either support or drive (depending on what side of the ‘what came first’ debate you stand). For a more thorough analysis of this, read our paper ‘Times are a Changing’ available as a download from the Insight page of the 1insurer web site. These fundamental demand-side shifts are one half of the issue. On the supply-side we have:

- The operational funds that insurers have to develop their business models in response to market changes
- New entrants funded by investors looking for the ‘next big thing’

In recent months the collective term InsurTech has emerged covering a range of activities. Misinterpreted by some as the technology behind insurance processing, which in some cases it is, it more accurately covers the new technologies that are disrupting the insurance space, and ‘spills’ into a range of start-up ventures, drawing in investment and driving innovation. These vary from wearables and smartphone apps to online policy and automated claims handling tools.

“May your choices reflect your hopes, not your fears”

Nelson Mandela
Smaller than its more established cousin FinTech, InsurTech is hyped as the game-changer for the industry, enabling insurers to embrace innovation, improve offerings and rebuild customer trust. Figures vary, but the investment in InsurTech has tripled to $2.65bn in 2015 (Source – PwC, 2016), which itself was almost 3x the investment in the previous year (Source – ABI). Some estimates place the level of investment in the last year (to June 2016) at $3.4bn. So current funding is accelerating as the success of FinTech begins to flow into the related insurance sector. As a result of all of these shifts, 74% of insurers expect insurance to be one of the most disrupted industries in the next 5 years. Note that only 26% of those outside the industry expect this result (Source – PwC, 2016), so the level of threat is sharply influenced by the perspective of the person you ask.

The irony is that insurers themselves are part of this investment/disruption trend with Aviva, Axa, Allianz, AIG, MetLife and XL Catlin, all establishing in-house venture capital funds with a commitment to invest $1bn in start-ups (Source – ft.com).

At this point it is worth highlighting two things: -

• Decisions on what to do with investment funding is a separate issue to the strategic challenge of disruption to the core business, and;
• InsurTech as a label is a ‘catch-all’ term for a wide range of products and services, many of which will be irrelevant to any specific insurer

On this last point, it has parallels with the ‘Internet of Things’; a convenient label covering a multitude of developments, including the sub-set of UBI which in turn covers some of the implications of driverless cars. These areas overlap and interact with each other to varying degrees of relevance, so, in a similar way, what InsurTech is depends on an insurer’s point of view… what strategic issues need to be addressed?

To this, add the open question of what tech giants such as Google, Amazon or Apple may do longer-term with the mountains of cash each have, either directly or indirectly through the continued development of automation. Insurer CEOs, more than any other financial sector, have expected tech giants to generate disruptive pressures so when Google launched into the motor aggregator market in 2015, insurers expected a shift in market dynamics. Within a year, to some surprise, they exited leaving the market much as they found it. So where does that leave the disruptive threat from digital players?

**WHY IT MATTERS**

Given the confusion around the subject it is not surprising that the approach insurers adopt varies widely. Despite the anticipated disruption highlighted in this paper, more than a quarter have no strategy to deal with FinTech/InsurTech development.

As demand and supply side factors fuel the market and devices, products and services proliferate, the ways in which insurance is delivered is likely to develop further.

An assessment of options leading to an agreed strategic position on the use of technology (and how to bring this about) will be key to longer-term market relevance
PEERLESS COMPETITION?

Equally intriguing is the possible growth in Peer to Peer insurance models. These bring together large groups of individuals who agree to pool their insurance premiums and insure one another at rates which are lower than they are currently paying to existing insurers.

The philosophy of Peer to Peer returns to the original ethos of insurance and collective risk, but is now underpinned by global connectivity, the reach of the internet and the proven mechanism of crowdfunding.

In April of 2012, President Obama signed The Jumpstart Our Business Startups Act (JOBS) of 2012. This, essentially, ushered in the concept of ‘crowdfunding’ in the US; the collaborative process of bringing together a large number of investors to financially support businesses or projects through internet ‘platform sites’. Crowdfunding allows business to raise capital inexpensively and easily from hundreds or even thousands of average citizens who can invest or donate minimal amounts through internet ‘platform sites’. As of 2014, there were 600 crowdfunding platforms in operation in Europe representing 48% of global providers and 375 the US (30%) – see opposite. Participants trigger the crowdfunding process and influence the ultimate value of the offerings or outcomes of the process. Each individual acts as an agent of the offering, selecting and promoting the projects in which they believe.

The proliferation of crowdfunding principles further erode the psychological barriers involved in trusting providers outside of the mainstream.

Analysts currently view Peer-to-peer (P2P) insurance as a ‘supplementary’ rather than ‘replacement’ route to market. Gartner (2014), for example, project a future where P2P occupies a distributive role in a connected eco-system, with traditional carriers providing the core elements of the insurance process (product definition, underwriting and policy management). In this scenario, the strengths of both P2P (connectivity and social reinforcement) and Insurers (operational delivery) are combined. Extension through partnership with retail and aggregator brands is probable. This arrangement is most likely in commoditized business lines (mature markets with established digital distribution mechanisms) such as Motor and Household. A time-frame of 10 years is likely for a more established eco-system to emerge.

That is not to say that such arrangements are not already being actively pursued. Notable early entrants include (Source - insurancetimes.co.uk): -

• Germany-based Friendsurance allows policy owners with the same insurance type to form small groups and have a part of their premiums paid into a cashback pool. If no claims are submitted, the members of the group get some of their money back at the end of the year. The company, which currently partners with 70 insurance firms in Germany and has raised over $15m in Series B funding. (finsmes.com).

• Lemonade claims to be the first P2P insurer to register as an actual carrier (in the US) and operates along similar lines to Friendsurance, raising $13m in seed funding from Sequoia capital. Based in New York it will focus initially on the US property insurance market (the-digital-insurer.com).

• Formed in 2013, UK based Guevara started offering standard motor insurance in late 2014. Customers are offered a choice of groups to join when they take an insurance policy. Premiums are split in two with one portion going into the individual group (the Protection Pool) and the rest going into a collective pot that supports all of the individual groups (Insurance Fees) (dailyfintech.com).

Significant barriers to wider adoption exist (trust, confidence, regulatory costs and processes, the volume needed to sustain the longer-term business case); so, Peer to Peer has a way to go before it represents a true challenge, but this is a long-term market and as the ‘digital generations’ mature the pull of collective, less structured action is likely to grow. Commentators advise a ‘watching brief’.
INNOVATION MATTERS

Insurance is playing catch up in a number of inter-connected areas, and the differences between reality and expectation has enabled gaps in service to be exploited by InsurTech startups.

The key question is how Insurers should respond as new products that impact on distribution and service and new, sometimes speculative, providers enter the insurance space?

At the heart of this is the issue of innovation and the possible angst around InsurTech is underpinned by a perception of poor innovation within the industry. Insurers themselves simply believe that they are not particularly good at innovating. Research by Celent (2015) indicates that over half of carriers (52%) surveyed thought they were worse than other industries with 61% feeling that they operated at a comparable or worse level than their peers (implying that the industry in general has an issue).

Further research (2016) highlights possible causes; recent studies show while 80% of insurance professionals agree innovation is critical to fulfil rising customer expectations, only 35% of them state it is critical to their business strategy. Celent believes it is this lack of alignment which hinders innovation and whilst investing in a new ‘innovation ecosystem’ is one option, the most likely model insurers will opt for is the partnership one, to accelerate the pace at which they can evaluate and close expectation gaps. However, examination of priorities around InsurTech uncovers an interesting issue of timing.

The ‘InsurTech – A Force for Good’ report from accelerator startupbootcamp, highlights six key areas of insurance startup activity and uncovers an imbalance between the ventures receiving funding and the areas that insurers themselves find most appealing (see Figure 3). In general, those areas receiving the highest levels of funding fall into less interesting areas for insurers.

This is most likely due to the lag between development activity and operational investment undertaken by insurers. Development takes place at the earliest point and insurers are largely attracted to technologies that have already proven their worth (most prominently digital and analytics); commonly adopted trends rather than speculative investment in possibly transformative technologies. The speculative money has already shifted elsewhere.

Figure 3 – Development Trends – Insurer v StartUp Priorities

Source - startupbootcamp
CONFLICTING CULTURES AND ROBOTIC ANSWERS

So, by their very nature start-ups are culturally the polar opposite to insurers. Start-ups are agile and more willing to take a risk but insurers by the very nature of their business are risk adverse and slow to try truly new activities.

Startup cultures simply generate the most change and insurers are often hindered by outdated legacy systems and the restricted thinking that these impose.

This mismatch is an opportunity as established insurers start to work out what emerging tech means to them and how the investment funds they have available are used to close both the ‘customer expectation’ and cultural gaps. Many of the new players emerging are enablers to innovation, complementing incumbent offerings. Celent (2015) argues they should be viewed as potential partners offering solutions to help insurers improve what they already do rather than looking to be disruptive and an ‘either/or’ decision. In working with InsurTech companies to develop and trial new technologies in partnership and help shape the outcome more proactively.

At the more speculative end of the InsurTech spectrum we find the robots! The explosive growth of computing power doubling approximately every two years (the semi-conductor industry refer to this as ‘Moore’s Law’) has enabled previously custom/high-cost activities to become standardized and automated. Software development has meant the same intelligent automation can now be applied through algorithms to all data types, even an individual’s behavior patterns including deviations from the norm. Awareness has moved on considerably thanks to the rise of the digitally connected world, where the vast quantities of structured and unstructured data generated from text, videos and audio files provide the fuel for automated development. The need to be able to quickly process and combine data sources to generate action has seen it applied to everyday tasks, where it is quicker and more efficient than its human alternative.

Natural Language Processing (NLP) has been brought to the masses thanks to technologies such as Siri, but insurance companies are beginning to see the value in monitoring social media to cross reference with claims notifications. This type of machine learning can be applied to recognize patterns to predict fraud and likely future behavior.

IBM’s ‘Watson’ is one such data analytics processor that uses NLP and advanced analytics to predict and problem solve. Capable of processing millions of documents and reading 800 million pages of data per second, it is easy to see the appeal of using such a platform to manage and process this amount of unstructured data. The solution eco-systems that IBM are piecing together are part of a long-term strategy to automate task management and, ultimately, target any human engagement on ‘must do’ relationship connections (under the concept of Knowledge Management – see 1insurer’s insight paper ‘Extracting Value Through Knowledge Based Competition’, available from the Insight page of 1insurer’s web site).

AI software is used in high volume, rules-based work and once programmed can replicate decision making processes and apply them quicker and more efficiently than human operators. Robotic Process Automation or RPA combines all the conceptual elements of AI/Robotics and enables humans to configure the technology or ‘robot’ in order to collect data, recognize patterns and learn from them in order to apply and adapt to new situations. By mimicking human behaviors, the robots are able to not only perform the tasks but also optimize them.

WHY IT MATTERS

Insurance remains a highly competitive market. For Personal Lines success is driven largely by effective cost control as margins are thin. Insurers benefit from automating as many routine tasks as possible.

However, there is a balance. Generational differences demand a mix of automated and personalized contact. This in turn requires a clear definition of the customer experience and a probable reworking of the underpinning processes and supporting systems.

Legacy systems remain a significant inhibitor.

To develop an RPA plan, like much of the InsurTech opportunity, insurers need to have the correct systems in place to integrate these new platforms into their business processes. Celent noted ‘one size does not fit all’ and the right partner [for each insurer] must be found for innovation to be successful. In turn this decision can only be made once the corporate strategy around innovation is clear. Paradoxically working, perhaps speculatively, with InsurTech partners may help evolve the right blend for a traditionally risk-adverse sector?
WHAT’S MY MOTIVATION?

So, if we accept that the pace of change is likely to accelerate and that the way in which consumers expect service delivery is likely to flex and change more frequently (both reasonable assumptions in the current climate) the question then becomes how an insurer is best placed to prepare for this?

What systems and tools does each need to deliver products and services against this background of more frequent change and interactivity?

Strategic choice relies on an analysis of two key areas: -

- **System Flexibility**, analysis of these factors will enable an insurer to assess whether the current system is comprehensive, stable and flexible/easy to adapt and change.

- **Market Complexity**, analysis of these factors will determine if the impact of anticipated change is wide-ranging or narrow; the lines of business, consumers and competitive pressures that the insurer is managing.

Four possible scenarios are likely:

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<thead>
<tr>
<th>END-STATE</th>
<th>DIMENSIONAL SUMMARY</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>READY &amp; ABLE</td>
<td>Flexibility high / Complexity low</td>
<td>The current system and process model meets current/likely demands – if you fall into this category then all is well and the disruptive backdrop of InsurTech is ‘hyped distraction’ that can be ignored.</td>
</tr>
<tr>
<td>RETHINK REQUIRED</td>
<td>Flexibility low / Complexity high</td>
<td>The current system and process model is incapable of meeting current/likely demands, most likely due to old and inflexible technology that is difficult to develop (at least in an acceptable timeframe/cost) or integrate with dependent systems – you are probably embarking upon, or are in the middle of a strategic replacement program; or should be.</td>
</tr>
<tr>
<td>EXTENSION NEEDED</td>
<td>Flexibility low / Complexity low</td>
<td>Aspects of the current system perform but important parts (e.g. digital distribution, analytics, claims servicing, integrating capabilities) lack sophistication – a case of ‘plugging gaps’ or extending capabilities.</td>
</tr>
<tr>
<td>TEST BED ENHANCEMENT</td>
<td>Flexibility high / Complexity high</td>
<td>Core systems are largely ‘fit for purpose’ given current demands but a ‘test and refine’ or ‘agile development’ capability for future growth would be advisable – access to an ‘on demand’ service platform to do this would be the next logical step.</td>
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Figure 4 below represents this analysis diagrammatically:

What category each insurer falls into will determine the ‘motivation’ for the next step. Which aspect of InsurTech, from the wide range of options, is most relevant.

Some general trends from the above are worth noting:

• The pace of InsurTech development is accelerating due to both supply and demand side pressures.
• Insurers are faced with a wide range of choice and a great deal of confusion and conflicting advice.
• Experimentation is high, not all products and services will succeed and mature.
• Insurers like to invest in winning options and for this reason often delay investment and experimentation.
• This has the potential to hand the initiative to ‘outsiders’ who operate to different business models or have the cash to undertake such experimentation.

WHY IT MATTERS

The insurance sector is unlikely to stand still.

While investment in core systems has picked up and many providers have taken steps to update or supplement existing processes, agility and speed remain key issues in an unpredictable landscape.

How can carriers continue to experiment with new technologies without committing significant sums of money?

InsurTech is likely expand and proliferate, so solving the investment question will be key to keeping in step with changing consumer demands and maintaining profit-margins in the longer-term.

The answer requires a ‘strategic map’ derived from an honest assessment of current system capability.
Given the unpredictability of the current market and the pace of change, it is worth all insurers reassessing their position on the use of technology to either replace, extend or supplement current business models. As ever in strategic decision-making, much will depend on an honest assessment of where the operation is and what the market is likely to demand.

Whatever this analysis uncovers, there is obviously plenty of choice ‘out there’ to deal with the development needs identified.

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