White Paper

MAKING SENSE OF TODAY'S INSURANCE MARKET

Bringing Business and IT Together to Drive Growth, Boost Revenue, and Reduce Costs

Abstract

This white paper discusses the challenges that the insurance industry faces and suggests revenue-growth and cost-reduction strategies to meet them. It also explains how a closer partnership between business and IT can make those strategies successful.

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Executive summary

Finally emerging from a difficult economic period caused by the financial crisis of 2008, the insurance industry has shown positive premium growth since the second quarter of 2010 and the rates of return on fixed investments have also improved. Although moderate, this growth signals a turnaround for the industry and, combined with recent capital pressures, may indicate the start of the next hard market for insurers.

EMC's Industry Advisory Services has examined the industry and evaluated the growth vectors and market disruptors impacting its profitability. Insurers have accepted they cannot wait on a slow economic recovery. They are realizing that actions must be taken now to drive underwriting revenue, reduce expenses, and gain market share.

The insurance industry faces a unique opportunity for change, riding a wave of transformation that has simultaneously altered business models and information technology. Our analysis has identified several themes centered on revenue generation and cost reduction that insurers can leverage to take advantage of this opportunity and gain market share at the expense of those who prefer the role of follower to that of thought leader.

In the course of expanding on these themes, we will offer our views on the challenges and prospects insurers face in regards to premium growth, product innovation, and the impact of changing demographics on their customers and their future employees. In addition, we examine the continued impact of fraud, the changing regulatory environment, and the application of disruptive technologies, all of which, if managed successfully, can lead to increased operating efficiencies.

Introduction

Insurance is a mature industry that has recently suffered through a recession. It still struggles in a weak, slowly recovering economy. Low interest rates on fixed investments have added pressure to those caused by traditionally low underwriting profits and anemic premium growth.

For example, in 2010 premium growth in the property and casualty (P&C) sector was just 0.9 percent. And the industry wide combined ratio for P&C, including mortgage and financial guaranty insurers, was 102.4[1]. Nevertheless, the 0.9 percent premium growth was the first positive growth in the P&C industry since 2006.

Metrics from sectors such as auto, homeowners, and workers' compensation also show moderate growth. So, there are signs that insurance as a whole is well positioned to move into the next hard market with a positive turn in premiums, an increase in cash reserves, and slowly recovering investments.

[1] "2010 – Year End Results" – Dr. Robert Hartwig, CPCU, Insurance Information Institute – April 20, 2011

An industry in transition

From the 1960s through the 1990s, all segments of the insurance industry experienced two trends: the emergence of national insurers that grew to dominance primarily through mergers and acquisitions and the beginning of a new business model—direct sales. Through this period, as desktop computers and client-server computing emerged, the industry was supported by purpose-built operational systems developed in house to meet the needs of an individual carrier.

With market consolidation largely completed over the last decade, a second wave of change gathered momentum. It was marked by slower growth and increased cost constraints driven by reduced consumer spending on insurance products. The financial crisis also meant lower returns on fixed investments that had become the primary revenue source for most insurers.

While coping with this radically different economic reality, the industry has had to face the prospect of replacing aging legacy systems that can no longer adapt to changing market conditions, including a more stringent regulatory environment and an increase in sophisticated fraud. But the most fundamental shift, which began in the last decade and will grow stronger in the next, is a changing consumer demographic.

In the next 10 years, customer relationships will change as Generation Y consumers, with their buying habits and service expectations, replace Baby Boomers[2] and become the predominant market force.

Baby Boomers often prefer a "curated" buying experience. They want someone to walk them through the buying process, especially with complex purchases like insurance. On the other hand, the Gen Y consumer relies on and actively solicits peer recommendations and reviews. Enterprise business models already show signs of adapting to these changes, with the incorporation of collaborative and social media tools into the traditional sales and marketing mix.

Online and mobile delivery channels will dominate, but the classic channels of agents and brokers will not disappear. The industry will have to support multichannel delivery, including agents and brokers. Successful companies will find a way to provide a consistent user experience and excellent service across channels.

IT transformation—accelerating the pace of business change

As economic and demographic changes demand new business models, IT transformation creates additional momentum and complexity. For example, in 2010 the number of virtual servers surpassed physical servers for the first time. Cloud computing greatly reduces the cost of software procurement, installation, configuration, and management, which gives enterprises greater opportunities to focus on their core businesses rather than "keeping the lights on."

Moreover, when technically savvy and highly connected workers enter the workforce—as they are in great numbers—they demand the same usability, 24/7 connectivity,

[2] "Baby Boomer" (born 1946-1964) "Gen Y" (Born 1977-1984)

and productivity on the job as they do in their personal lives. And they display a marked preference for using their personal devices for work. The dissolving separation between work and personal life means that even as data centers consolidate, information continues to disaggregate while it increases in volume and variety at a staggering pace.

The magnitude of consumer and market information that exists outside the enterprise firewall has created a new discipline: Big Data and analytics. Big Data represents one of the greatest opportunities—and challenges—today's commercial organizations face. Many enterprises have trouble simply storing their Big Data, with limited to no ability for analysis. Others manage terabytes or even petabytes of data, but struggle to derive the meaningful insights from it that improve decision making.

Change fosters opportunity

Of course, along with the disruption of change comes opportunity. EMC believes that insurance organizations should explore six success or opportunity vectors in two categories: revenue and cost.

Increasing revenue

The revenue-centric success vectors comprise boosting premium growth, introducing product innovation, and exploiting demographic changes.

Boosting premium growth

Over the next three to five years, insurers can increase premium growth via five tactics, each with its own advantages and risks.

- Mergers and acquisitions

Mergers and acquisitions present opportunities for insurers to acquire a new book of business, improve distribution channels, gain a presence in an emerging market, or acquire smaller rivals. However, depressed market valuations encourage acquisition targets to hold out for a stronger market. At the same time, the regulatory environment and tax concerns put additional pressure on this growth vector.

- Emerging markets

With emerging markets, insurers can look to countries, such as India and Brazil, with new wealth, disposable income, and a low penetration of insurance products. But it is clear that growing markets are no longer low risk markets.

- Expansion of traditional lines of business

Insurers can also look to expand traditional lines such as medical services, health insurance, and workers compensation, assuming they're willing to navigate increasingly complex regulatory waters.

- Deeper market segmentation

Market segmentation, which takes a large market and breaks it down into smaller markets, is nothing new. For example, the automobile insurance market can be segmented based on a product lifecycle framed from the consumer's perspective. From ages 16 to 25, the insured may simply be in search of the most economical insurance that will meet legal requirements. By age 50, there may be substantial assets at risk from litigation or settlements stemming from an accident.

These instances are two very simple market niches. With the wealth of consumer information now available, micro segmentation is a tantalizing possibility. But it requires a robust data analytics infrastructure.

- New distribution channels

Distribution channels are also evolving—and not just via the Internet and mobile devices. Co-marketing partnerships with banks, car dealerships, and associations such as AARP offer opportunities to grow market share if insurers have an underwriting system flexible enough to accommodate them. A partnership between Answer Financial, a division of Allstate, and Overstock.com enables consumers in all 50 states to submit insurance information at Overstock.com and immediately receive free, side-by-side quotes from over 20 leading insurance providers.[3]

Introducing product innovation

Insurance products have traditionally been most heavily marketed to affluent customers. Growing market share and increasing products per household requires that insurers develop cheaper, less complicated niche products tailored to the lifetime value of the customer. And they must reduce the time it takes to bring these products to market.

When insurers can leverage affinity groups and crowdsourcing during the product development cycle, it produces a competitive advantage. These tactics can slash time to market by incorporating direct consumer input into functions, features, and expected behaviors early in the development process.

Social networks can also refine marketing techniques in ways that support brand awareness and drive growth through education and peer recommendations. A recent JD power insurance survey suggests that if the insurer can create an unaided awareness of the brand, the consumer is four times more likely to request a quote, which in turn leads to a six times greater likelihood of purchasing a product.

Exploiting demographic changes

A major market disruptor across all industries is the replacement of the Baby Boom generation with Generation Y. Like every generational shift, this one will affect organizations that want to sell to the next generation and employ them.

[3] "Insurers Join the Ranks of Overstock.com – firm partners with Answer Financial, launches O.co Insurance tab to offer home, auto quotes." – Pat Speer, Insurance Networking News, July 18, 2011

Customers

The Gen Y demographic represents 30 percent of the population and will grow into the largest consumer segment over the next decade. Gen Y consumers really are different from Boomers. Insurance companies that ignore this do so at their peril.

Gen Y is better educated than its predecessor, more informed and more connected. Its members are tech savvy, accustomed to real-time information 24 x 7, and prefer self service and freedom of choice. They are more transient and more accepting of change—at least in this stage of their lifecycle. They seek and use competitive information and are keenly aware of their purchasing options.

Right now many Gen Y consumers are graduating from college, moving, changing jobs, starting families, and making major purchases such as cars and homes. Every consumer segment goes through this stage and it’s a revenue sweet spot for insurers.

But Gen Y consumers are hard to capture and harder to retain. They are much more likely than Boomers to switch providers if their service expectations go unmet. And they frequently offer and act upon testimonials and recommendations from social networks, friends, and family.

The traditional sales and service channels offered by insurers have not adapted to the Gen Y consumer, who remains underserved, dissatisfied, and exhibits low policy retention rates.

As JD Power notes, "if the Generation Y consumer carries forward its current insurance buying habits, it could be catastrophic to industry profitability."

Employees

The insurance industry is facing a talent crisis, with 20 percent of its workforce at or near retirement age, and less than 12 percent of CPCUs under the age of 40. Moreover, the industry suffers from a poor reputation, and will likely have difficulty attracting Gen Y employees who accurately view the industry as lacking in technology innovation and whose business practices seem stuck in the 1970s.

Gen Y individuals come to the workplace with many expectations brought forward from the ways they communicate and interact with people and leverage technology in their personal lives. This generational cohort will gravitate towards industries that are seen as doing things better, faster, easier, and smarter. In order to attract and retain this next generation of worker, the insurance industry will need a new image and a new model of productivity.

Reducing cost

Regardless of whatever revenue growth initiatives insurers pursue, cost reduction will remain a mainstay of profitable operations. EMC believes three areas hold tremendous potential.

Preventing fraud

Fraud hits the bottom line in nearly every industry. Fraudulent insurance claims account for at least 10 percent of all claims' payouts. It's a $40 billion a year problem that adds hundreds of dollars a year to consumer premiums. The Federal Bureau of Investigation estimates that "hard" and "soft" fraud costs the average family $400-$700 in additional premiums every year.

Hard fraud schemes are very complicated, often involving organized crime. But soft fraud, such as premium evasion, is much more common. According to Quality Planning Corporation, which verifies policyholder data for automobile insurers, even something as simple as underestimating the number of miles driven costs insurance companies three billion annually.

Fraud pervades the buying, selling, using, and underwriting of insurance and has been called the "second largest economic crime in America" by the Coalition Against Insurance Fraud.

Meeting regulatory challenges

Insurance is a highly regulated industry and regulatory risk remains a critical concern for insurers. For example, the explosive growth of unmanaged data—and its potential to breach increasingly stringent privacy regulations—pose one of the greatest challenges to effectively managing risk and exposure. The ability to embrace regulatory change quickly and effectively in whatever domain it occurs is a competitive advantage. An information governance infrastructure that can manage compliance and adapt quickly to change minimizes the cost and disruption of shifts in regulatory policy.

Leveraging information technology

Information technology holds a lot of promise for insurance companies. But before that promise can be realized, most face the task of replacing legacy line-of-business applications that in many cases are 20 to 30 years old. These systems cannot adapt quickly—or at all—to changing market or regulatory conditions. They don't provide a holistic view of the customer, integrate easily with other applications, or offer the ability to collaborate in real time. The costs of application decommissioning, data migration, and new technology will not be cheap. But companies that don't make these investments will lose their ability to compete.

Insurance companies can put five technologies to work:

- **Cloud computing** provides an elastic, scalable, and high performance environment that significantly increases the speed of new application deployment without the up-front capital expenditure required for traditional IT services.
- **Process automation** can help insurers establish consistency and control over their business processes and institutionalize the knowledge of senior underwriters and subject matter experts. It also enables insurers to address the need for constant modifications to their policies and procedures.

- **Collaborative tools** can help insurance carriers streamline complex processes that involve multiple individuals interacting and exchanging information. Enterprise collaboration represents a huge potential set of efficiencies and opportunities for rethinking core processes.[4]
- **Big Data analytics** can augment and enrich customer insights, financial management, risk assessment, fraud prevention, and day-to-day operations.[5] A strong alignment between business and IT can create powerful new capabilities within an insurer's organization.[6]
- **Information governance** can help insurers create a framework to ensure the confidentiality, quality, and integrity of data, which is essential to meeting the requirements for internal and external audits, enforcing records retention, and complying with state and federal regulations. At its best, data governance roots out risk and effectively ties information policy to business strategy.[7]

Conclusion

The insurance industry is adapting to the demands of a new business model and to the need for a more flexible and responsive IT infrastructure to support that model. To increase revenue, market share, and products per household, insurers must look at growth vectors and market disruptors that boost revenue generation and help contain costs. Insurers that are successful will:

- Forge a collaborative partnership between business and IT
- Focus on customer loyalty and retention
- Deliver consistently excellent execution and front line performance
- Provide a consistent multi-channel experience
- Introduce product innovation through techniques such as crowdsourcing
- Develop a deeper understanding of risk and pricing
- Turn greater data insight into actionable information

As a trusted industry advisor, EMC has of history of helping bring business and IT together in the insurance industry. We can help your business operations and information technology divisions bring real change to the organization. By looking at technology through the prism of revenue generation as well as operational efficiency, you can drive business growth and gain market share.

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[4] Josefowicz, Matthew. "Sharing Alike." *Insurance Networking News*. (2011): Web. 16 Dec. 2012.
[5] Smallwood, Deb. "What Does Big Data Really Mean for Insurers?." *SMA Perspective*. (2012): 3-4. Web. 16 Dec. 2012.
[6] Ibid.
[7] Velarde, Diane. "Eight Steps to Effective Data Governance for Insurance Companies." *Information Builders*. (2011): 3. Web.