

Insurtech: Disruptions and Opportunities in the Insurance Industry

The promises of financial technology, or fintech, have dominated many discussions about innovation in the banking industry. The insurance industry, meanwhile, has found itself far behind. But this appears to be changing. In the not-so-distant future, we think “insurtech” could significantly alter the business models and competitive landscape of the insurance industry.

These changes will have important implications for global investors, particularly since financials represent the largest share of most indexes. And while numerous banks and insurance companies make up this share, intra-sector correlations are high, and these stocks tend to move together as a block. This is especially true when the market cycle is relatively mature, as it is now and will be for the next few years.

Recently, insurtech has garnered increasing attention from venture capitalists, startups, and insurance companies. According to CB Insights, a tech market intelligence company, insurtech startups raised US\$2.65 billion in 2015, an increase of 3.5x from a year ago.¹ Oxbow Partners estimates that there are currently more than 1,500 insurtech startups.² Advances in technology and data analytics can improve and transform the entire insurance value chain, from customer acquisition and product development to underwriting and claims management.

Insurers lag in innovation

Insurance – a global industry of US\$4 trillion in total premiums³ per year – is a complex business that involves sophisticated risk pricing, large capital requirements, and stringent regulations. High barriers to entry and a relatively long payback period make the business a rather unpopular choice for new entrants. Unlike in many other industries, the internet has, so far, resulted in little disruption to the insurance industry. For many insurers, business models have remained largely the same during the past 30 years.

Even though the industry is mature, insurers face significant opportunities for growth. Many areas of the world remain underinsured; Swiss Re estimates that the mortality protection gap in the Asia Pacific region alone amounts to US\$58 trillion.⁴ A study undertaken by Lloyd’s concludes that the shortfall in non-life insurance premiums among a sample of 42 countries exceeds US\$150 billion.⁵ In the UK, one-third of households have no home contents insurance, and only 12% have income protection insurance.⁶ While accessibility and income levels affect insurance penetration, the homogeneity of risk-pricing models often results in less affordable insurance solutions, particularly in low-income economies where insurance needs are arguably the greatest. However, recent advances in insurtech have the potential to dramatically improve insurance penetration in the long term.

The Disruptive forces of insurtech

The advent of the Internet of Things (IoT) has the potential to significantly improve risk pricing, which lies at the core of every insurance business. Connected devices – telematics, connected homes, and wearable devices, to name a few – can generate large amounts of data that result in more accurate risk assessment of each individual policyholder. The falling costs and rising prevalence of these connected devices can reduce information asymmetry and drive major changes in insurers’ risk-pricing models. With more accurate and targeted risk assessment, insurers can offer products and solutions tailored to each individual customer’s needs and risk profile.

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¹ <https://www.cbinsights.com/blog/insurance-tech-startup-funding-2015/>

² <https://www.linkedin.com/pulse/insurers-startups-how-play-nicely-together-greg-brown>

³ *Global Insurance Insights*, McKinsey Global Insurance Pools, 2015 edition

⁴ *Asia Pacific 2015 Mortality Protection Gap*, Swiss Re, July 2015

⁵ *Lloyd’s Global Underinsurance Report*, Lloyd’s, October 2012

⁶ <http://inclusioncentre.co.uk/wordpress29/the-financial-inclusion-challenge/key-facts/insurance-and-protection>

The rise of autonomous vehicles

Ever since Google announced its self-driving car project, automakers have developed a number of accident avoidance features such as adaptive cruise control and automatic braking. Automakers such as Ford, Nissan, and Tesla have announced plans to develop and introduce self-driving vehicles over the next few years. The increased prevalence of self-driving vehicles and accident avoidance capabilities could significantly lower the frequency of accidents in the long term. KPMG estimates that over the next 25 years, the total industry loss costs from personal auto insurance could shrink by as much as 60%, which would result in significant pressure on overall premiums for auto insurance, often the largest insurance line for many property and casualty insurers.⁷

Take MetroMile, for example. MetroMile is a US-based auto insurance startup offering pay-per-mile insurance, which appeals to the approximately 70% of car owners who drive less than 10,000 miles per year. MetroMile offers its customers a free GPS telematics device and driving app that measure miles driven and collect data such as routes and car diagnostics. Since there is a clear correlation between miles driven and frequency of accidents, MetroMile specifically targets a lower-risk customer segment that might otherwise have been overpaying for auto insurance. In the near future, we expect more and more vehicles to be equipped with telematics devices and smart driving apps. This should have a significant impact on the product and pricing of auto insurance over the long term.

For health insurers, wearable devices help collect a wide variety of biometric data, including physical activity, stress level, and cardiovascular health, that can be linked directly to health insurance products. A number of health insurers are already offering premium discounts tied to fitness level. At Oscar Health, a US-based health insurance startup, customers receive a free Misfit fitness tracker and can earn small sums of money by hitting a target number of steps each day. The attraction for health insurers is simple: Active people are generally healthier, so they likely make lower-risk (and more profitable) customers. The collection of biometric data can result in more accurate assessments of health risk and lead to customized health insurance products.

Improved data availability and targeted risk assessment could also generate potentially profitable opportunities for insurers among higher-risk and often underinsured customer groups, such as individuals with pre-existing medical conditions. And new insurance products could be created to serve innovative businesses such as Airbnb and Uber.

MetroMile and Oscar Health are but two of the many insurtech startups working to capture potential profit opportunities along the insurance value chain, including the digitalization of claims process, fraud detection and prevention, underwriting, and distribution. Insurtech could accelerate the disintermediation of traditional distribution channels. Currently, around 10% of life and property and casualty (P&C) premiums in China are sold through online channels. Meanwhile, a large proportion of insurance businesses is still generated through insurance brokers, whereby insurance companies have little direct interaction with end customers. McKinsey estimates the average age of insurance agents in the US to be around 59 years old, with a quarter of the agency force expected to retire over the next five years.⁸ Innovative online platforms and apps could become a powerful distribution channel by offering greater transparency in pricing and product options. The development of tailored insurance products for individual customers will foster more direct interaction between the insurer and the end customer, resulting in further disintermediation of the traditional distribution channels.

Opportunities for incumbent insurers

Incumbent insurers could be a major beneficiary of insurtech. In addition to product development and risk pricing, insurtech could improve the cost and efficiency of

Many Insurers Are Investing In Insurtech Initiatives

Insurer	Investment/Partnership
AIA	The AIA Accelerator: startups selected to come to Hong Kong to accelerate their health tech and/or wearable businesses
AXA	Kamet: a EUR100 million insurtech incubator
Allianz	AllianzDigital Accelerator: identifies and explores insurtech opportunities for Allianz
MetLife	LumenLab: a Singapore-based innovation lab with a focus on insurtech opportunities in the Asian markets
Aviva	Digital Garage: a separate team to explore and develop insurtech opportunities
Manulife	Lab of Forward Thinking (LoFT): Lab devoted to generating innovative business solutions
China Pacific Insurance	Plan to invest at least RMB1 billion in a joint venture with Baidu to launch a digital insurance platform
China Taiping Insurance	Plan to partner with Alibaba to establish an internet health insurance company with RMB1 billion of capital
FWD	Investing in iFWD, a digital platform to distribute online insurance products
MS&AD	Acquired a 75% stake in UK-based telematics insurer Insurethebox
Mass Mutual	Mass Mutual Ventures to invest directly in insurtech startups

Source: Company Reports, Daily Fintech, and PineBridge Investments.

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⁷ <http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/automobile-insurance-in-the-era-of-autonomous-vehicles-survey-results-june-2015.pdf>

⁸ <http://www.ibamag.com/news/marine/one-in-four-insurance-agents-will-be-gone-by-2018-17943.aspx>

customer acquisition and engagement, the underwriting process, fraud detection/prevention, and claims management. Many insurers recognize the need to innovate and adapt to the latest technological advances, and a number of insurers have already invested in insurtech initiatives and partnerships.

While insurtech has allowed startups to grow market share in certain product segments, incumbent insurers still have an enormous advantage. They have well-established brands, capital, business infrastructure, and a vast customer base. With stronger understanding of the insurance market and existing customers, incumbent insurers can better capitalize on insurtech to grow and expand current businesses. The large incumbents can readily offer novel insurance products once these products prove to be viable. For instance, Manulife's new MOVE program in Hong Kong offers premium discounts to customers hitting a daily target number of steps. With personalized risk assessment, future insurance products could evolve toward a single policy covering all personal insurance needs such as home, auto, health, property, and travel. The incumbent insurers are better positioned to develop and popularize the concept of customized insurance solutions.

Insurtech will likely have a long-lasting impact on the competitive landscape of the insurance industry. Competition from insurance startups could result in pricing pressure for lower-risk customers in certain products such as auto insurance. More accurate risk assessment and customer segmentation could open up new market opportunities in previously underinsured customer groups. The potential emergence of customized insurance solutions could spur greater demand from both existing and new customers. While an expansion of the insurance market and deepening of insurance penetration should benefit both incumbents and startups, competition will undoubtedly intensify between the innovative startups targeting niche product segments and the well-established incumbents embracing insurtech to expand their revenue opportunities. The biggest competition will likely come from the well-capitalized incumbent insurers that can best adapt to and capitalize on the growth opportunities made available by this new technology. Meanwhile, the biggest winner of insurtech should be the end customers, who will benefit from better user experience, more personalized insurance solutions, and possibly improved pricing through cheaper premiums.

Identifying innovation

While the global insurance industry could evolve in countless ways in the near future, we're certain that it will be much different in five to 10 years. For instance, some insurance startups may become listed on stock exchanges, expanding opportunities for investors.

And while the development of insurtech holds great promise for the insurance industry, it also brings plenty of uncertainty for investors. How will insurtech change insurers' business models and long-term earnings drivers? Will insurtech significantly alter the pricing of basic insurance policies? How will insurance evolve given the prevalence of telematics and self-driving capabilities in automobiles? How will insurance regulations change with the developments of insurtech? These are just a few of the many questions that investors in the insurance industry should be asking.

The rapid development of insurtech and the resulting changes in the insurance industry will have significant implications for global investors. We think the best way to distinguish among the hundreds of stocks in this large sector is through vigorous bottom-up stock research to identify innovation. And while many investors tend to focus on traditional short-term assessments, we think identifying longer-term competitive advantages (which few insurers are likely to have) is key to investing in this market – now more than ever.

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Blockchain and insurtech

The applications of blockchain technologies (digital ledgers of transactions) and the concept of smart contracts can be applied to insurance policies. At the London Fintech Week hackathon last year, the winning team presented a smart contract system for flight insurance. Each year, around 550,000 passengers in the UK do not claim for a delayed or canceled flight. As flight information is readily available in public records, the smart contract system automatically provides claims payment to the policyholder if the relevant flight is delayed or canceled. The smart contract system helps eliminate claims processing costs, prevents insurance fraud, and improves customer satisfaction through immediate claims payment. As long as the insurance policy conditions are clear and payout triggers are objective, such a policy can be written into a smart insurance contract.

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