Maximize the potential and avoid pitfalls in developing and implementing insurtech

INSURANCE COMPANIES are facing a once-in-a-generation series of changes to their industry.

The demographic passing of the torch from baby boomers to Generation X and millennials is well underway and will continue to accelerate. In addition, trends in policy sales, premiums and ownership of insurance products have made the need to innovate more urgent and less discretionary.

Winners in the industry will be those that develop products, tools for analysis and distribution methods that fit in the current marketplace and appeal to a different generation of consumers.

Technology-enabled innovations in the insurance industry — or "insurtech" — present both intriguing possibilities and risks for potential acquirers of these technologies. Here are some trends in insurtech and some things that insurance companies should consider in evaluating the possibilities and mitigating the risks.

MARKET TRENDS

According to recent data from the U.S. Census, millennials (those aged 18-34 in 2015) now outnumber baby boomers (ages 51-69 in 2015) as the largest living generation. In 2015, there were more than 75 million millennials in the U.S., and that number is expected to grow as immigration adds to this number. In addition, the demographics of the millennial generation look much different than previous ones. According to Pew Research, millennials are less likely to be married, own homes or cars, or purchase goods and services in the same way as their parents.

Insurance companies have already seen the effects of these changes. According to data from SwissRe, real premium growth (adjusted for inflation) for life and non-life products has slowed from an average of 6.8 percent from 1984-1994 to an average of only 1.5 percent from 2004-2014.

DEAL TRENDS

Insurance companies are increasing their pursuit of insurtech innovations to improve customer experience, lower costs and make pricing and underwriting more efficient. According to Accenture, global investment in insurtech more than tripled from $800 million in 2014 to $2.6 billion in 2015.

These innovations can impact product development, underwriting, front- and back-office operations and distribution channels. For example, insurers are reaching new customers through new distribution mediums while not disturbing traditional channels. These distribution models address the generational shifts in the way people communicate, access information and make decisions. According to a Gallup poll, millennials are more than twice as likely as other generations to purchase policies online instead of through an agent.

Start-ups such as CoverHound and PolicyGenius cater to that preference by providing user-friendly platforms for fast comparison shopping, and each has received significant investments from major insurance companies – PolicyGenius from AXA, Transamerica and MassMutual; CoverHound from Chubb.

Other insurers are using wearables and monitors to provide usage-based products or rewards that are integrated with customers' lives in a way not usually associated with insurance. Products with social components may not resonate with baby boomers, but they may be used to reverse declining sales trends with the larger generation of millennials.

For example, Willis Towers Watson has reported that large percentages of millennials prefer usage-based insurance to traditional coverage and are willing to trade personal information for reduced rates. Insurance companies such as Progressive and State Farm have rolled out usage-based Auto insurance products that personalize the coverage based on driving activity.

In addition, data analytics and predictive models have become more sophisticated and are being used more widely in marketing, underwriting, claims processing and fraud prevention. In the M&A market, we are seeing increased emphasis on developing or acquiring proprietary analytics, models or other processes.

INNOVATIONS, OPPORTUNITIES AND THREATS

Overall, we have seen two general categories of insurtech innovations: those that are additive to current models or products, and those that disrupt existing business lines or the industry/market as a whole. Either type of innovation can create a competitive advantage, and both may be worthwhile to pursue. Which one is chosen is based on a number of factors, including the maturity of the technology or the target company, the way in which the insurer plans to incorporate the technology into its business and the level of resources that a company is willing to commit to developing the innovation.

In theory, the opportunities are almost limitless. Across the financial services industry, decades-old assumptions are being challenged by industry leaders and start-ups alike. All are seeking to exploit the first-mover advantage by applying new technology to established markets. Those that are successful will shape the direction of their industries and establish market-leading products for years to come.

The threats associated with these innovations are varied and can arise from ill-considered actions as well as the failure to react to competitors and industry changes.

Investments in insurtech can drain resources – capital, human, institutional or reputational – and distract an insurer from its core business or other development opportunities.

Ill-conceived insurtech investments can also result in a loss of advantage versus competitors that adapt and implement technologies more efficiently and effectively.

Attempts to integrate insurtech into existing businesses may lead to cultural clashes among employees in different business lines as well as employees of different generations.

These integrations should be carefully planned and managed to ensure that any "disruptions" are both intended and positive.

DEVISE A STRATEGY

Insurtech is an often-discussed and high-priority issue for insurance executives and strategy groups; however, the pursuit and application — and value-add — of insurtech is neither uniform nor unanimous across the industry. There is no one-size-fits-all approach, and companies need to develop their views on how to pursue insurtech opportunities and how insurtech fits into their businesses and culture.

When developing or investing in insurtech, it is also important to determine the legal risks and have the resources — and appetite — to address them. By its nature, innovation pushes the envelope, and in a highly regulated industry such as insurance, outside-the-box innovation could run afoul of regulations and lead to headaches (or worse) for the company. Compliance teams and counsel should vet new applications of technology to determine appropriate boundaries and limitations on the use of the technology. In addition, it may be appropriate to reach out to regulators to gauge their reaction to ideas and to prevent unwelcome surprises when deals or new services are announced.

In addition, the structure of the deal or investment should reflect the company's long-term strategy. The potential deal structures range from licensing and service agreements to internal incubators and acquisitions, and each reflects varying level of commitment and resources.

For example, it may not be appropriate to acquire and fully integrate an insurtech startup if its technology is only expected to tangentially impact a company's product line or service model. On the other hand, a company may choose to devote more resources — and supervision — to a high-stakes and transformative new product development. In either case, a company should carefully consider how its business and culture may be impacted by the influx of new ideas and the people that will develop them. NU

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