

DeRisk

CRISIL's insights and analyses of regulations, macroeconomic factors, guidance and trends affecting the insurance industry

January 2021

Dawn of the digital insurer

The new insurer is becoming well-digitalised for tomorrow's customers

CRISIL has examined several topics relevant to the business transformation agenda of the insurance industry since 2019, in earlier issues of DeRisk. Notable among these were: the adoption of new accounting standards, model risk management, alternative asset investment, digital transformation, machine learning model governance and workforce innovation.

Two years down the line, these topics have not only become more significant than ever, but also acquired a momentum not seen in the past 20 years.

With the Covid-19 pandemic telescoping digital transformation in virtually every field, this issue of DeRisk takes a close look into the makings of the new 'digital insurer.'

What's driving the rise of digital insurance?

A shift from the traditional onsite work location to entirely virtual teams, corresponding with firms' wider access to employees in different locations, are further consequences of the global pandemic. For instance, Google searches using the keywords 'work from home' more than quadrupled in the first quarter of 2020.

Moreover, the insurance industry finds itself at the top of a list published by the International Monetary Fund (IMF)¹ on the level of workability of various industries in a virtual environment.

The mobility restrictions imposed by 'stay-at-home' has only served to accelerate the trend towards this virtual setting: whether to work or to transact. Consumers are steadily seeking out digital solutions for financial products, including purchase of insurance (digital brokerage). Keyword searches for 'digital online insurance' tripled in the fourth quarter of 2020 compared with the same quarter in 2019.

Digital insurance means different things to different stakeholders. Even as consumers are looking for peace of mind (by protecting an asset or mitigating risk from an unforeseeable event), they want quicker, more transparent access to products. They expect to be served on a digital insurance platform that is both convenient and relevant to them. While consumers appreciate human interaction, users of the digital era attach more value to innovation or digital gadgets linked to their products than a friendly face or voice from an agent. Put simply, they want to view, manage and optimise their insurance products without delays.

Digital insurance is much more than a convenient app or platform to buy insurance; it also matches gadgets with products. For example, wearable devices track biometrics and provide users incentives such as premium reduction for those with healthy habits (in the case of life or health insurance applications). They contain mechanisms that better reflect consumer behaviour or custom needs, such as telemetry data for car-driving habits that can lead to savings ('pay as you drive' products). All these require upgraded digital insurance platforms, systems and processes to serve consumers.

¹<https://www.imf.org/en/Publications/WP/Issues/2020/06/12/Who-will-Bear-the-Brunt-of-Lockdown-Policies-Evidence-from-Tele-workability-Measures-Across-49479>



For insurance firms, on the other side, aiming to be part of the digital insurance era can be hard. The rhetoric of “we have been doing business for more than x years” does not cut ice here. The speed of change compels the industry to move and adopt solutions that serve this generation of customers and their approach shapes the way the market responds to them. Thus, looking outside the box and involving external firms to help them make this transition is critical. It is no coincidence that ‘insurtech’ funding has risen exponentially over the past five years.

What’s your insurer type?

Insurers have adopted their own unique ways of adhering to risk management and supervisory frameworks and reflect upon the lessons learned from the pandemic. The year 2020 was also challenging in terms of performing this self-recognition exercise to identify opportunities. One of the top initiatives in the health and life insurance industry was elimination of the medical examination, in order to conduct efficient and cheaper underwriting processes. Though this was not a new need, it became obvious that conducting health examinations to sell insurance during a pandemic would lower sales.

Based on the response to this global event, insurers may be divided into four kinds:

Exhibit 1. Types of insurers



1. The arguers – who are still circumspect about an actual negative effect from the pandemic on their business and have a narrow view on liability and actuarial experience analysis. They have a stubborn mindset and believe that decades or centuries in the business is enough to secure their market position.



2. The firefighters – who are responding to needs from various over-the-top business areas in the current environment, including finance and investment functions. They have a short-term view in problem solving; for example, those who wanted to eliminate medical exams for underwriting for some time but only did it in 2020.



3. The transformers – who view the prevailing environment as a growth driver and are accordingly transforming their business models. These firms are open to engagement with third party firms and insurtechs and have started talking about how to embrace the digital era.



4. The avant-garde – who are pushing a real digital agenda and addressing evolving consumer product needs while innovating their risk management function. They include those who have already set up an attractive digital brokerage platform and offer gadgets to consumers.

The digital disruption in insurance has radically changed the nature of consumer demand. Now, customers want more control, in which they can compare, easily understand, and effortlessly buy insurance products with a simple claim process. While the ease and efficiency of the claim process is crucial, the user experience in digital insurer platforms, websites, apps, wearables and product solutions also plays a considerable role in the purchase decision. Hence, the third and fourth kinds of insurers stand higher chances of success.

New offerings on the digital block

The evidence of growth in digital insurance is difficult to support with hard data, however, there are clear indications of companies and products that reflect the evolution. Examples include, the rise of:

- **Peer-to-peer (P2P) insurance:** The use of social networks has empowered consumers to identify common needs and risks (the very foundation of mutuality in insurance). These networks are building digital insurance solutions to mitigate their own risk without relying on insurers, like the German P2P Friendsurance.²
- **App interface insurance:** New insurers are emerging that offer consumers speed in buying insurance or receiving claim payments without human interaction, such as the American insurer Lemonade.³
- **Gadget-based products:**
 - Biometric devices, where the overall objective is to screen users who have a wearable device and wish to purchase health or life insurance. The technology uses a points system to provide rewards or incentives, with rewards including premium discounts or programme cost elimination for those participants who have better health habits. Canadian insurer Manulife⁴ is a case in point.
 - Telematic devices, which allow consumers to enrol and benefit from a programme where they pay per mile or ‘pay as you drive’ with the help of a hardware device connected to the on-board diagnostics car system. American insurer Allstate⁵ is a good example of this.

²<https://www.friendsurance.com/>

³<https://www.lemonade.com/>

⁴<https://www.manulife.ca/personal/vitality.html>

⁵<https://www.allstate.com/tr/car-insurance/telematics-device.aspx>



Is the 2021 agenda for insurers set in stone?






We think the answer is ‘No’. On the contrary, flexibility and adaptability will be the key differentiators.

For example, in response to the IFRS 17 adoption date change by the International Accounting Standards Board (IASB) for the second time (moved now to January 1, 2023), we observed that many insurers deferred expenditure on IFRS 17 implementation in 2020.

Thus, while this item was previously on the transformation agenda of insurers, it has now been passed over in favour of more urgent customer-focused initiatives such as digital provision.

An articulated strategy for this year should focus on business transformation and technology. In fact, the initiatives presented in Exhibit 2 below are already underway or completed by ‘the transformers’ and ‘the avant-garde’ insurers (mentioned in Exhibit 1 above).

Exhibit 2. Priorities for insurers in 2021

	Initiative	Why it is important?	How to start?
	Customer experience	It is imperative to improve product appeal and benefits to influence the target audience	<ul style="list-style-type: none"> • Refresh consumer portals and systems • Invest in product management and engagement/review campaigns
	Cybersecurity	The expanding virtual market has increased the exposure to threats of information hacks and frauds for consumers and insurers	<ul style="list-style-type: none"> • Identify most vulnerable and weak areas to cyber risk transfer that need to be shielded • Engage with relevant vendors and solutions to mitigate cyber risks
	Shield models	Models are subject to multiple risk factors, requiring better scenario tools to enhance the predictive power	<ul style="list-style-type: none"> • Track and include relevant risk factors in models • Develop a toolkit to monitor, benchmark and validate models
	Collaboration	Talent is more widespread; workflow integration incentivises cross-functional solutions across business functions (i.e, investment + finance + actuarial + underwriting + marketing)	<ul style="list-style-type: none"> • Rotate junior and mid-level employees every two years • Implement an actuarial workforce innovation programme • Encourage a collaborative culture
	ESG adoption	Investors are gradually but more frequently prioritising investments in ESG-compliant ⁶ companies ⁷	<ul style="list-style-type: none"> • Develop a corporate ESG policy • Liaise and collaborate with international organisations • Mitigate traded risk by enhancing the adoption of platforms to develop better risk modelling

Proposing and following an agenda is easier said than done, not only because it involves various stakeholders and the board of directors, but also because of the stage the insurer is in with respect

to these items. That is why, beyond prioritising initiatives, firms must hold a mirror to themselves and identify specific attributes or their lack, which could transform them into avant-garde insurers.

⁶Need to add example of compliance criteria. For example, adherence, UN, regulators, etc? Add expanded

⁷Add expanded acronym for ESG here.

Finding attributes to stay relevant

Insurers are reshaping their ability to understand and respond to fast-evolving consumer preferences and needs, more than ever before.

While consumer interest has declined in auto and some specialty insurance lines such as business interruption or travel insurance, due to stay-at-home mandates worldwide in 2020, interest in health and life insurance has grown strongly. Despite this, there has been no significant product innovation in these fields.

In the particular case of the annuity business, pensioners who fell victim to the pandemic and whose benefits passed on to beneficiaries, if any, generated a positive liability experience.⁸ Despite this, no initiatives are on the radar to enhance annuity or pension

products. In fact, these areas have seen only minimal change in two decades, so it is not surprising that demand for them has been stagnant of late.

Consumer preferences and events affecting the business environment will continue to evolve and challenge the industry. Hence, calibrating insurance offerings to increase consumer attention is essential, even if the transformation process is slow. The insurance transformation is among the slowest in financial services, especially when compared with the banking industry.

Exhibit 3 shows the most relevant attributes insurers must attain to survive.

Exhibit 3. Attributes for avant-garde insurers



These attributes are not only forward-looking requirements for the industry, but also lay the foundations of the insurance business for the next quarter century. Without focusing on achieving these attributes, mere emphasis on the priorities in Exhibit 2 is unlikely to attain relevance.

Technological evolution and the pace of societal change together offer a unique historical opportunity to transform financial services. This could be the turning point from where insurers innovate products, offer better benefits to consumers, and expand coverage. Reimagining the industry is, now, actually permissible.

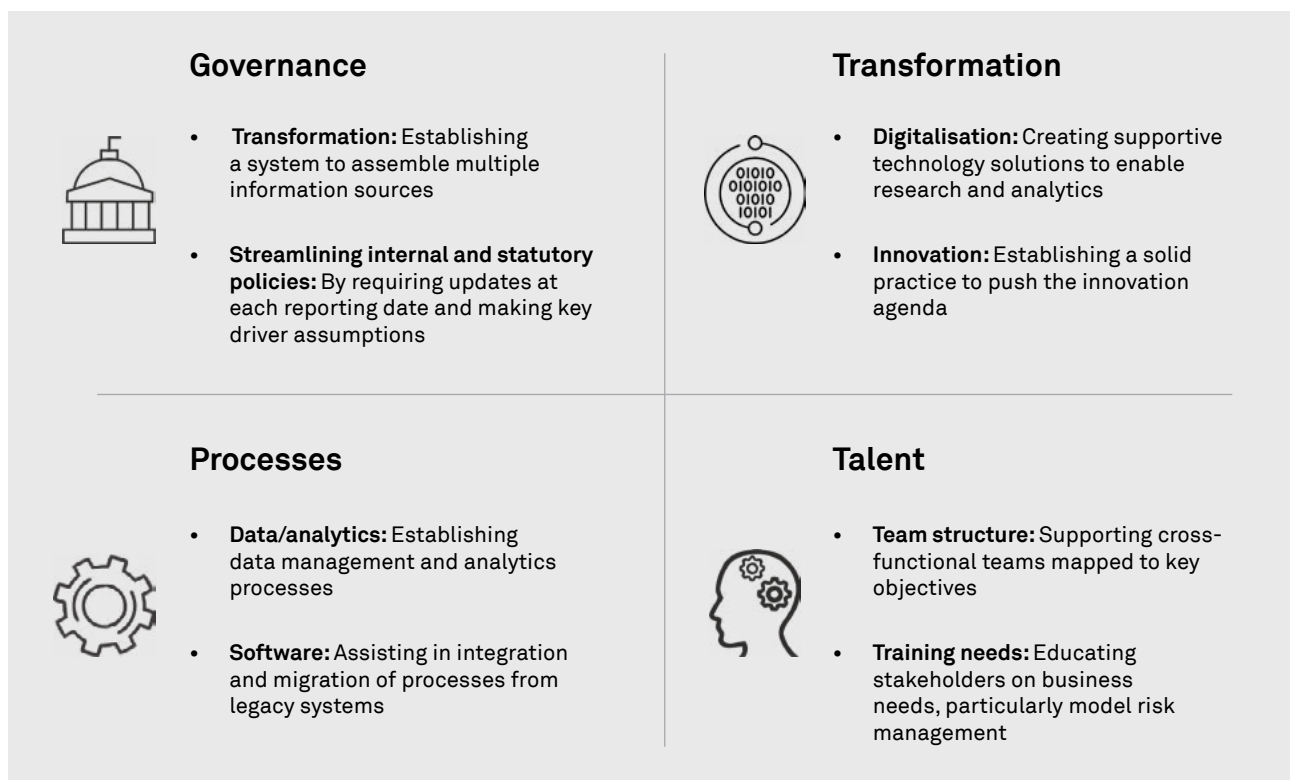
According to multiple insurance journals and other sources, Artificial Intelligence (AI) will lead this change in the next decade. While we concur with this view, many prerequisites are still absent. For example, many organisations are still operating with copper wires instead of fiber optics. Forward-looking enablers such as AI will not resolve today's problems, if adoption readiness is low: a classic case of putting the cart before the horse. Readiness will be defined by the insurer's business culture, attributes and agenda priorities.

⁸Do we need a footnote for this?

Our vision of your priorities

The transformed insurer is not only actively dealing with issues discussed in this paper, but also constantly evolving in step with changing consumer needs. Exhibit 4 shows how CRISIL can help navigate the complex and intricate priorities of your 2021 agenda.

Exhibit 4. How CRISIL can help you



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