

Digitization in life insurance: a prerequisite for success in spite of low interest rates



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To successfully deal with low interest rates, life insurance companies should become leaner and focus more on the customer by introducing new products or employing innovative business models. This article argues that, although the Holy Grail in this regard has not yet been found, without digitization all attempts will end in vain. By introducing a digital ecosystem management platform, we show how innovation can take place in an environment empowered by technology.

Setting the scene

The most painstaking problem the life insurance industry is currently facing is the need to deal with a persistent environment of low interest rates. Most global life insurance assets are related to financial products, including guarantees, for which the risk-free interest rate cannot sustain guaranteed returns anymore. Furthermore, when historically low interest rates rise again this might pose a challenge as traditional annuity products sold today benefit only partially from higher interest rates resulting in rising lapse risks in the future.

Figure 1 shows how three strategies with different levels of digital maturity and innovation can be employed to navigate the storm.¹

In this article, we will focus on the necessary prerequisites for any digitization approach to be successful. Digitization is defined as «the conversion of text, pictures, or sound into a digital form that can be processed by a computer»² or, more simply put, the conversion of analog information into digital information. In a business context, this definition is not quite accurate. We at BearingPoint understand it as a shifting paradigm: how organizations need to view

and engage with technology. Digitization is about improving access to information for all stakeholders and building a more responsive, customer-focused organization with the help of new technologies. Therefore, digitization is important not because of its continuously changing underlying technology, but because of the way it is causing organizations to rethink how they use these technologies.³

Digitization is a company-wide concern and different dimensions need to be taken into account to ensure a successful transformation. Figure 2 illustrates the seven most important aspects in order to achieve high digital maturity.

The most holistic aspect of digitization is Strategy and Change Management. If digitization is not an integral part of the strategy of an insurer, it is very unlikely that benefits of a full transformation can be reached. Furthermore, employees must possess the right mindset, skills and capabilities to ensure that a digital mature culture emerges which is savvy with new technologies, open to change and focused on the customer. These overarching principles have to influence all other aspects of the transformation process since only on this foundation digitization can work and innovative business models flourish. Otherwise, there is the risk that digitization is only understood as another project among many and is regarded as an initiative with limited impact on certain processes. For example, with regard to customer orientation Oliver Bäte, CEO of Allianz SE, is convinced that it is all about a «complete renewal of business models, coming from the customer needs, not simply to automate existing processes, but to reinvent [them] ...».⁴

In the following chapters, we discuss in more detail how the three strategies –

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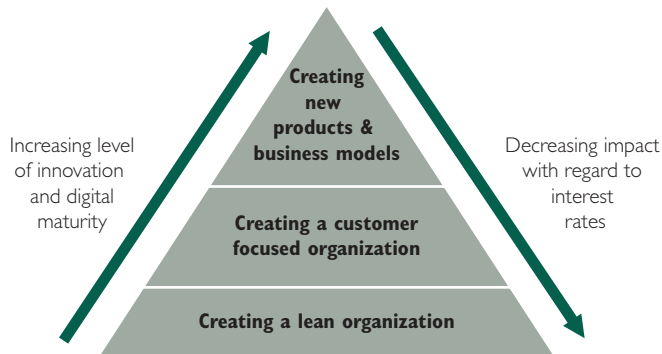


Figure 1: Possible strategies for life insurers to counter a low interest rate environment

creating a lean organization, customer focus as well as innovation – rely on digitization.

Creating a lean organization

If a life insurer wants to focus on becoming a leaner organization three aspects of digitization are important:

- Back Office and Processes
- Big Data and Smart Analytics
- Technical Enabling.

All of these aspects lead to incremental improvements of existing business functions and can therefore be integrated without a fundamental cultural or strategic transformation. For example, the optimization of processes by offering automatically generated offers for risk policies is straight forward.

Employing Big Data and Smart Analytics is difficult from a technical perspective but less so from a cultural one. The technical challenge is deciding which data sources are relevant and excelling at data management and security. Still, the overall goal of better assessing risks and doing so in the most efficient manner is well understood by life insurers. The same is true for Technical Enabling. Most life insurers would agree that their legacy systems are not state of the art. IT landscapes need to evolve in order to share information with all stakeholders, make use of big data and automatize

processes. The initial investments might be painful, but if an organization cannot handle data appropriately there is no need to consider staying in business in an industry where intangible assets matter the most. Take for example the In-Force Management initiative of the Zurich Insurance Group.⁵ The goal is to increase value generation from existing portfolios. As the project targets many business areas, it is much more than optimization. As a starting point, though, it replaces legacy systems and creates an agile IT infrastructure.

Focusing on this part of digitization is necessary and creates value in the mid term. Providing existent services in a more efficient manner and optimizing processes should be in the interest of every company. Especially as this stage of digital maturity can be reached with only minor cultural changes, making the necessary implementation efforts manageable. Though, optimization alone cannot be the solution since the vulnerability of the product portfolio to low interest rates remains.

Creating a customer focused organization

A more holistic approach is to increase customer focus. With this strategy, a more pervasive path to digitization is necessary, which builds upon the aspects mentioned in the previous chapter. This

further step relies mainly on the following: Front Office and Customer Relationship Management.

New technologies need to be employed so that customer expectations can be anticipated and handled. This means, for example, that the touch points between the customer and the company are designed to the needs of the customer and not vice versa. It should be possible for the customer to effortlessly reach the life insurer through any available channel. If the customer prefers to manage his products exclusively via mobile apps this should be possible.

For example, Swiss Life's myWorld is a web portal dedicated to the needs of digital natives.⁶ It offers customers the possibility to manage nearly all insurance related issues online. Of course, this cultural and technical switch requires substantial investments in the beginning. In the long term, though, cost reductions can go hand in hand with a more customer oriented organization. It is just important that all processes are seen from the customer's perspective.

Another example is Big Data. Without a shift in perspective the usual opportunities can be seen as better risk segmentation and cross-selling opportunities. If another perspective is taken, however, a life insurer can become a partner. Gathered data can be used to offer the most suitable insurance solution to the customer in combination with providing further insights. Why not tell the customer when he should switch to another insurance or savings product or when people with his characteristics regularly miss out on certain tax advantages? Swiss Life's myWorld goes in this direction.

The overall point is that the customer has to experience that the insurer follows his needs and habits. This requires that the organization integrates digitization into its strategy. Otherwise, only marketing brochures will change and no matter how much money is spent on this initiative, the company will miss out the digital age.

Creating new products and business models

One obvious path for life insurers is to offer products without return guarantees and let the interest rate risk remain with the policyholder. This has the advantage that the product can be adjusted to the risk preferences of the policyholder and reacts flexibly to changes in interest rates.

The question remains, though, if the needs of people who seek life insurance products are met. Is a variable annuities contract or a risk life policy an end in itself? Certainly not. The customer is yearning for safety. More specifically, take for example a woman advancing in her career who is building a house and has a nice husband as well as two lovely children. She is worried about what would happen to her beloved ones if she cannot provide the income anymore – no matter for what reason – and seeks out a solution, which gives her peace of mind. Therefore, any life insurance product is just a means to an end for her and bearing an additional risk (e.g. interest rate risk) is deteriorating her objective.

What does this have to do with digitization and low interest rates? As illustrated in Figure 2 the following is an aspect of the transformation process as well: New Products.

Examples from other industries successfully showed that the needs of people can be addressed directly with the help of digitization. Mobility can be provided

without owning any cars, trains or planes (Uber) and shelter can be offered without possessing real estate (Airbnb). So, it would be astonishing if there would not be a company in the future offering safety in life and wealth without relying on interest rates. The first step is done by start-ups with the vision to provide automatically the necessary and best suited insurance products for clients in real time (e.g. GetSafe and Knip). Though, it is certain that the journey will not end there and in the future companies will find ways to provide safety in life directly. One can only speculate how these business models will look like and betting on any one of them at the moment is probably unwise.

One truth, however, is crystal clear: digitization is the key in order to be able to adopt and to stay competitive in this new environment. Just think about the biggest department store (Amazon), the most successful marketing company (Google) or the fastest growing TV network (Netflix). All these companies have in common that they shook up their respective industry with a disruptive business model. Each one is based on an excellent employment of information and new technology in order to better serve the needs of the customer. There is no reason why the same should not happen in the life insurance industry, too.

In order to create new business models based on digitization all aspects need to be considered and a certain maturity has to be achieved. In particular, we believe

that one aspect is important: Market Participants and Cooperations

A continuous evaluation of the market and the needs of the customer is indispensable. What are the aggregators, innovators and disruptors? How is the market changing? How can collaboration be facilitated?

More specifically, a digital ecosystem management platform can be used as an example of a business model enabled by digitization. The idea of such a platform is to provide a central focal point for all stakeholders: customers and service providers (not just life insurers). Figure 3 illustrates the concept of such a platform.

Customers are looking not for a specific product, but for an efficient and comfortable way to satisfy their needs. From this perspective it seems totally unnatural that there are different channels to buy a car and a car insurance. The same is true for the realm of planning for retirement. Offering annuity products with limited continued payments in the case of death is common. Why not offer at the same time legal advice for creating a testament? If someone has the urge to leave something behind, is it not natural to specify for whom? The ERGO Digital Lab for example had the same questions and tries to find out if a viable business model for ERGO can be generated.⁷ The same is true in the case of risk life insurance. Imagine, as it is common, that a policy is purchased with the goal to

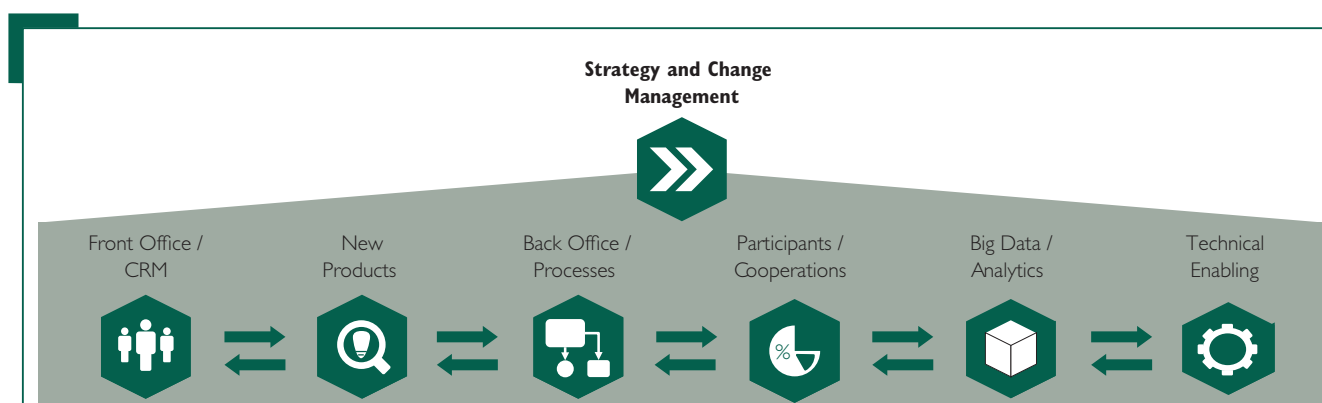


Figure 2: Dimensions of successful digitization

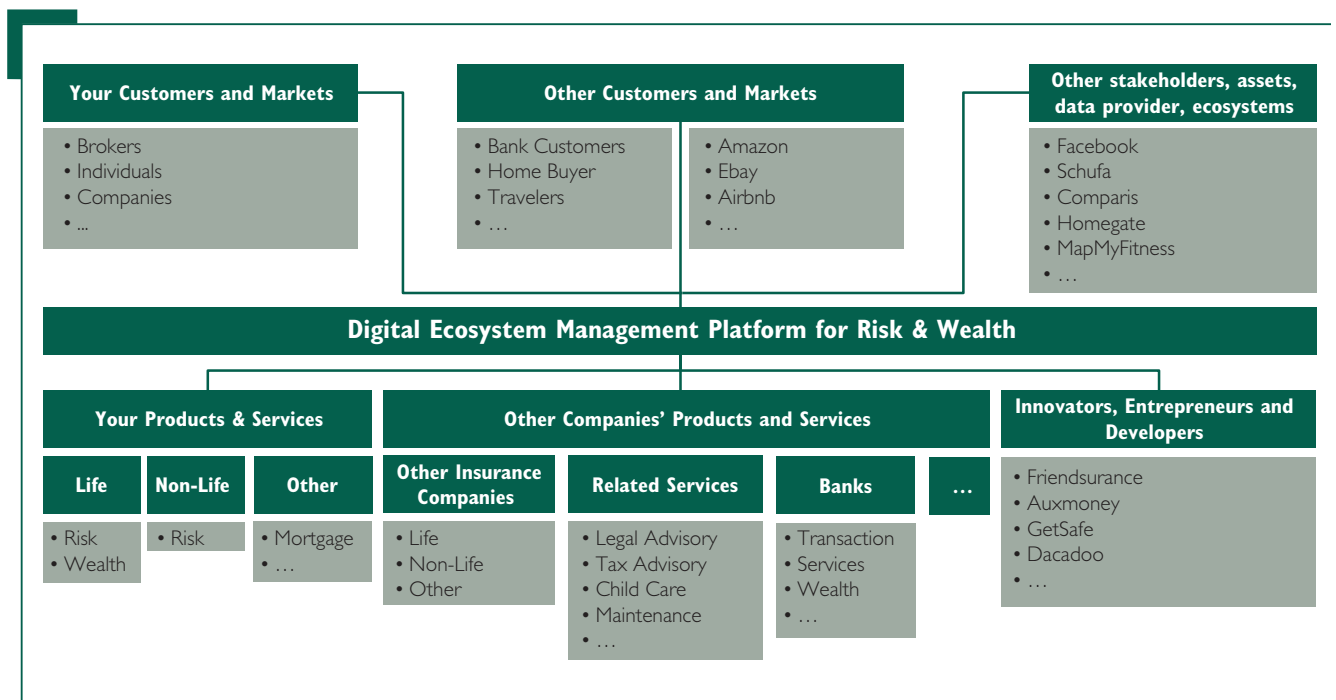


Figure 3: Description of a digital ecosystem management platform for risk and wealth

guarantee that the family's house does not have to be sold when the main provider of the household income has an accident. Why not offer a service agreement for upkeeping the house? A platform offering all these services from different providers would be very convenient and it is more than certain that at one point in time such a platform will emerge. Rakuten, a Japanese company, offers a platform which is pretty close to this concept and is already offering life insurance products.⁸

From the perspective of service providers such digital ecosystem management platforms are innovative as well. Firstly, they would be open to offerings from different companies and industries and therefore could dynamically adjust to upcoming customer needs. A life insurer might not be willing (e.g., funeral services) or able (e.g., construction) to meet some customer needs, but an open platform would. Secondly, information could be shared efficiently and effectively within and among service providers. If a call agent hears a child crying in the background, for example, this information could be interesting for the insurance sales division but also for the travel agency offering child-friendly holidays.

Thirdly, new business models could emerge via increased differentiation in the value chain. Take for example indirect underwriting and risk taking. Information sharing and communication with insurance brokers could not only improve, but brokers could get certified and do the underwriting directly. The insurance company would in this case only design the insurance policy and manage the claims handling. Third parties would do the underwriting and risk taking.

The huge benefits of such a platform also reveal its threats: while the owner of the platform is in a powerful position, the individual service provider without any stake in the platform is exchangeable.

Conclusion

The current low interest rate environment is a challenge for traditional life insurers. Basically, there are three possible ways to respond to this situation. First, driving down costs by becoming a very lean company. Second, providing additional value by increasingly becoming customer focused and, third, inno-

vate with new products and business models.

Becoming a leaner company and focus on the customer is fruitful, but might only be a temporary relief since, if the current trend of low interest rates continues, the situation will become even worse. In addition, a sudden rise in interest rates in the future would increase the risk of rising lapse rates. Creating products without return guarantees and shifting the interest rate risk to policyholders seems to be sustainable and is already pursued by many life insurers.

However, a real competitive advantage can only be achieved by more directly addressing the needs of customers: people are looking for safety when buying life insurance products, not for annuities with or without return guarantees. Which business model will eventually satisfy the customers' needs is not clear, although we at BearingPoint believe that a digital ecosystem management platform will be part of it. In general, though, we are sure that whether a life insurer tries to become leaner, more customer focused or engages in entirely new business models, successful digitization is a crucial prerequisite for any approach.

Notes

- 1 For existing portfolios an improved risk management by putting these into run-off and eventually selling them might be an option, too. However, this is a backward perspective and in this article we focus on solutions for life insurers writing new business.
- 2 See: Oxford English Dictionary.
- 3 See: From IT to Digital: Assessing the Organizational Impact, Stephen McLaughlin, November 2014.
- 4 See: Allianz hat Zukunftssorgen, Versicherungswirtschaft heute, Tagesreport, June 2015.
- 5 See: https://www.zurich.com/_/media/dbe/corporate/docs/events/investor-day-presentation-2015.pdf?la=en
- 6 See: <https://myworld.swisslife.ch/#/home/start>
- 7 See: «nachlass Begleiter» <http://www.nachlassbegleiter.de/>
- 8 See: http://global.rakuten.com/corp/about/strength/business_model.html

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