The Changing Value Chain in the Insurance Industry

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In 2005…

*Insurers will strive to balance IT's role in improving customer interaction, distribution effectiveness and operational efficiency.*

- To meet market and customer expectations, **insurers must excel in their core activities** - such as product development and processing - while enhancing their interactions with customers and distributors.

- Insurers' **operational efficiency must be improved**. Initiatives to reduce the costs of operation and streamline internal and external processes must be the foundation for customer, distributor and internal improvements.

- The way insurers deal with **regulatory change is now a key competitive issue**, as it affects the economics of individual products, the structure of the marketplace, and the risk/reward balance for each and every institution.
Insurance Industry Transformation

New emphasis on product is critical

- Insurers were swept away by the concept of CRM
- The customer-focused strategies shifted insurers' attention away from operational excellence. Investments consequently suffered in core operations, such as systems to expedite policy or claim processes.
- Operational efficiency is the true foundation for a customer focus. Lacking streamlined and intelligent back-office policy and claims processes, insurers can't drive increased service quality and sales revenue.
- Change in focus: shifting from customer-facing activities to supporting product development - leaving customer interaction to their distributors. Insurers should focus on crafting new insurance products that:
  - Meet changing customer needs
  - Are highly personalized
  - Can be sold effectively via the distribution channel
Key Challenges for Insurers

- Executive:
  - Increasing shareholder value
  - Measuring ROI
  - High value customer acquisition and retention strategy
  - Managing risk and (capital) exposure
  - Governmental regulations and compliance reporting

- Operational:
  - Need cross-channel view of customers
  - Calculating cross-channel commercial effectiveness
  - Inaccurate profitability measures

- Marketing:
  - Little automation of repeatable processes
  - Missed up-selling and cross-selling opportunities
  - Increased acquisition and retention costs
  - Ineffective understanding of (customer) needs

- Information Technology:
  - Mergers and acquisitions
  - Too much unleveraged data
  - Multiple, disparate data sources
  - System integration difficulties
Major Business Strategies

- Achieve sustainable underwriting profit
- Globalization and Branding
- Convergence and Bancassurance
- Re-engineer all internal processes for maximum efficiency
- Re-underwrite all business, shed unprofitable lines and accounts
- Build efficiency and STP into claims handling
- Carefully evaluate and renegotiate reinsurance agreements
- Reduce fraud
- Maximize all distribution channels
- Employ more sophisticated risk modeling
- Consolidate/automate/outsource back office operations
Dynamic business environment

- Increasing customer expectations - consumers expect \textit{ubiquity of customer service around-the-clock}

- Low entrance barriers for FSP from other industry sectors - \textit{consumers start comparing their experiences} with leading retailers

- Consistent growth in customer promiscuity and sensitivity - \textit{consumers are better informed}, comparing products and prices on the Internet

- Cost control and operational efficiency – increasing customer retention but quid \textit{efficiency in segmentation}?

- Decreasing share of wallet - \textit{“customer loyalty” has vanished} and the majority of customers bank elsewhere, but not necessarily with banks

- Core product set is unsuccessful, \textit{normal insurance customers will never be profitable} and the target customers are probably not money-spinning (enough)
Multiple views of the truth

Insurance company

- Customer
- Life
- Auto
- Mortgages
- Property
- Health
- Other data

Product driven sales attempts

Potential sale
The New Business Value Proposition

*Deliver what the customer wants; when, where and how they want it*

**Objectives:**
- Transfer risk
- Plan for the unforeseen
- Achieve financial security

**Preferences:**
- Meaningful Products
- Reasonable price
- Strong, stable provider
- Fast Superior Service
- Internet, phone or personal touch points

**Transactions:**
- Coverage types purchased
- Payment preference
- Payment history
- Ease of purchase
- Private, secure transactions

**Products:**
- Standard
- Customized
- Reasonably Priced

**Services:**
- Speed & ease of purchase
- Speed & ease of inquiry
- Sound Advice
- Fast, efficient, fair processing
- Convenient to customer

**Delivery:**
- Telephone
- Mail
- Internet
- Agent Office
- Customer Home/Office
- Alliance Partner

**Psychographics:**
- What are they thinking?

**Demographics:**
- Who they are
- What they have
- What they do
- What they like
- Where they live

**Condition:**
- Need for product
- Desire for product
- Need for other products
- History of purchases

**Seamless & Convenient**

Insurance customer

Insurer
Technology and the Value Chain

- Segmentation / Data Mining
- Cross-Sell
- Partnerships
- Product Development
- Campaign Management
- Rating Accuracy
- Real-Time Quote Generation
- Quote Management
- Quoting Engines
- Electronic Fulfillment
- Workflow
- Document Management
- EBPP Options
- Sales Efficiency
- Information Access
- Cross-Sell
- Needs Assessment
- Wealth Management
- E-Commerce
- Consistency
- Electronic Information Access
- Business Rules Engines
- Exception-based Processing
- Workflow and BPM
- Document/Content Management
- Operational Efficiency
- Cost Containment
- Information Access
- Loss Reduction
- Claims Management
- Fraud Detection
- Business Rules Engines
Echoes of the industry

- Management Information needs to be improved.
  - Greater knowledge and transparency of the profitability of clients, relationship managers and products is fundamental.

- While competing to attract new clients, the most successful insurers will be those which protect and retain existing clients who fall within their target segments.
  - Insurers’ knowledge of clients still needs to be increased. It is critical that products and services provided to clients match their needs. Segmentation is becoming ever more important.
  - Developing a deep understanding of client needs, and building a holistic approach to handling client relationships will be key.

- Innovative analytical methods are putting a new face on traditional performance measurement.
  - These tools can identify the role of personnel issues in driving business outcomes and identify the drivers to improve results.
Competing for Clients

How Financial institutions perceive revenue growth and what drivers shape the industry landscape

Which elements do you have in your retention process?

- Monitoring of complaints
- Identification for clients targeted for retention
- Monitoring of activity levels
- Standard response times for complaints
- Client satisfaction surveys
- Identified individual for all major complaints
- Compensation mechanisms

Do you have a defined retention process to maintain valued clients which are currently at risk?

- Yes
- No
- Don’t know

Source: PwC, 2004
Competing for Clients

How Financial institutions perceive revenue growth and what drivers shape the industry landscape

Level of understanding of clients' needs

- Overall financial goals
- Extended family issues
- Risk tolerance
- Investment objectives
- Pricing concerns
- Information / Communication
- Service levels
- Products

- Very limited understanding (25%)
- Moderate understanding of clients' needs (50-75%)
- Good understanding of clients' needs (over 75%)
- Understands all needs and anticipates future needs

Source: PwC, 2004
Competing for Clients
How Financial institutions perceive revenue growth and what drivers shape the industry landscape

Which external sources primarily account for your revenue growth?

- Strategic alliances: 40%
- Mergers & Acquisitions: 20%
- New clients acquisition: 15%
- Market appreciation: 10%
- Greater use of intermediaries: 5%
- New clients won from competitors: 2%
- More business from clients: 1%

Source: PwC, 2004
Top-of-Mind Issues…1

- Capitalizing on customer intelligence
  - How can I create a **single view of the customer**?
  - How can I calculate true **customer profitability across product lines**, channels, and organizational boundaries?
  - How do I maintain current **customer loyalty** while I expand into new markets?
  - How do I identify and serve my profitable customers?

- Increasing operational effectiveness
  - Can I create a **closed-loop planning, budgeting, and reporting process** that allows me to manage enterprise performance?
  - How can I maximize my **agency network** investment?
  - How can I **optimize my IT infrastructure**? How can I remain cost competitive with outside providers?
  - How can I make the most of my investment in **human resources**?
Deep Analysis needed for Success

- Risk Profiles
- Claims data
- Sales data
- External data

Extraction / Collection

Analysis

Which agents are selling more of which products?
Which products are selling better in which geographies?
What is the loss ratio per product line in different geographies?
Which agents have as more than 60% of his entire portfolio, the products that have loss ratio higher than 85% in his geography?
... and even more!

For age group 35-40, how does renewal premiums contribution on comprehensive household product vary across states?

For a particular gender, what percentage of claims are attributed to various age groups, where the vehicle is less than 5 years old?

How does this vary across geography?
Multiple views of the truth

Insurance company

- Customer
- Life
- Auto
- Mortgages
- Property
- Health
- Other data

Packaged solution

Single view of customer

Customer need assessed, understood and answered
Effectively Managed Customer Equity

- A customized approach is essential given that
  - the top 20 pc of the customer base typically contributes up to 150 pc of its income
  - the bottom 20 percent actually reduces income by as much as 50 pc
  - normal customer generally prove not to be profitable.
Out of a sample of 3 million clients, moving 1/3 of the zero profitable customers up one segment generates an increased client profit contribution of €75m per year.
Analytical CRM?

- Customer understanding, Know-Your-Customer (KYC)
- Marketing Optimization
  - Efficiency
  - Effectiveness \( \text{Return on Investment (ROI)} \)
- Program Development geared to KYC and enabling to calculate
  - Prediction of customer lifetime (value)
  - What is the product that is most likely to be placed
  - Which is the level of investment / expense to be spent on customers
- Learning how things were done in the past to determine how they are going to be handled in the future
- Start considering products as tools for a successful next sales
Maximize Return

Customer Segmentation vs. Marketing budget allocation
Linking two dimensions…

<table>
<thead>
<tr>
<th>Churn probability</th>
<th>Number of customers</th>
<th>Loss of income</th>
<th>Loss of profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>81% - 100%</td>
<td>20</td>
<td>20</td>
<td>20</td>
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<tr>
<td>61% - 80%</td>
<td>20</td>
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<tr>
<td>41% - 60%</td>
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<td>21% - 40%</td>
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It's critical to have information which...

- Enables the identification and management of a customer's **real value**
- Identifies **costs and their drivers** on a basis which enables the effective management of business units
- Allocates the cost of risk inline with **where the risk is incurred**
- Supports and enables an **enterprise-wide** management
- Supports the transition process of becoming a and acting like a **customer-centric** organization
Top-of-Mind Issues…2

- Managing risk and preventing fraud
  - How can I manage risks (especially credit risks and operational risks) in an increasingly complex environment?
  - How do I stay ahead of increasingly sophisticated fraud perpetrators?

- Improving regulatory compliance
  - How can I comply with an increasing array of regulation?
    - Anti-money laundering
    - Solvency II
    - Sarbanes-Oxley
    - Do Not Call Registry
    - International Financial Reporting Standards (IFRS)
    - Emerging compliance regulation, Financial Services Action Plan (EU)
  - How can I gain business benefits out of these investments?
The impact of legislation

- Regulatory change does not have a uniform effect on the whole of financial services. How equipped is the industry to meet the challenges ahead?
  - Many firms have failed to create structures that will deliver a strategic solution to regulatory change.
  - Many firms would like to create a strategic data framework able to supply common data across all reporting environments; but many rely on ad hoc, tactical solutions for managing individual change programs on a discrete basis.

- If firms can deliver a strategic solution to their regulatory change programs, they will achieve real benefits.
  - They can look to develop an adaptive approach to regulatory systems, delivering lower costs when future changes are required and increased benefits from making best use of the data generated.
Echoes of the industry

- **Corporate governance:**
  - There are considerable overlaps between Solvency, IFRS and the Sarbanes-Oxley Act.
  - Organizations that understand how to maximize synergies and avoid costly duplication will be the winners.

- **Risk Management:**
  - Impact analyses undertaken by many banks have identified dozens of shortcomings that are now being fixed by quick and potentially conflicting isolated, expensive IT projects that may not deliver the value for the business that are envisaged.
  - One-third of respondents stressed the company’s Board had ultimate responsibility for preventing or managing economic crime – but only just over a quarter had given their boards any risk management training.

- **Anti-Money-Laundering & Fraud issues:**
  - Economic Crime remains a significant threat: 37% of respondents out of 100 banks report significant economic crimes during the previous two years generating an average loss per company of USD 2,199,930
  - The impact on reputation, brand image, and staff morale is often more important than the direct financial loss.
The Regulatory Responses

*What does the industry think about the growth in regulation and how equipped is it to meet the challenges ahead?*

Does your business have a single coordinating team for all regulatory change programs?

- Yes: 29%
- No: 66%
- Don’t know: 5%

Do you think the amount of IT resources dealing with regulatory change will increase?

- Decrease: 0%
- Stay the same: 83%
- Increase: 17%

Source: Institute of Financial Services, 2004
The Regulatory Responses

What does the industry think about the growth in regulation and how equipped is it to meet the challenges ahead?

Are you planning to have a single regulatory data architecture/data warehouse covering CAD3, Solvency 2, IFRS and Sarbanes-Oxley?

- IT professionals
  - Yes: 50%
  - No: 50%
  - Don't know: 0%

- Risk and compliance professionals
  - Yes: 26%
  - No: 39%
  - Don't know: 35%

Source: Institute of Financial Services, 2004
The Regulatory Responses

What does the industry think about the growth in regulation and how equipped is it to meet the challenges ahead?

Is your business coping well with the volume of regulatory change?

- Yes: 50%
- Coping – but a considerable strain: 30%
- Don’t know - no comment: 13%
- No: 7%

Do you believe you will see significant operational improvements and improved risk control from current regulatory change programs?

- Don’t know at this stage: 26%
- Yes: 30%
- No: 8%
- 66%

Source: Institute of Financial Services, 2004
Critical issues

- Asset & Liability Management
- Capital management
- Portfolio management
- Reinsurance
- Pricing and reserves
- Optimization of the product portfolio
- Risk management
- Performance Management
- Underwriting
- Cost management
- Claims management

Corporations need a risk-based capital model
# Risk based capital model

<table>
<thead>
<tr>
<th>Insurance risks</th>
<th>Claims</th>
<th>Biometric risks</th>
<th>Reinsurance risks</th>
<th>Market risks</th>
<th>Operational risks</th>
<th>Fraud risks</th>
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<tr>
<td>Premium</td>
<td>Prospective claims</td>
<td>Death</td>
<td>Deficit of reinsurance</td>
<td>Market risk</td>
<td>Business risks / cancellations</td>
<td>Money Laundering</td>
</tr>
<tr>
<td>Reserve</td>
<td>Retrospective claims</td>
<td>Long levy</td>
<td>Credit Worthiness</td>
<td>Credit risk</td>
<td>Operations risk (IT, HR...)</td>
<td>Claim fraud</td>
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<tr>
<td></td>
<td></td>
<td>Occupational</td>
<td>Multiple Parties / Agencies</td>
<td>Others</td>
<td>Customer lapses</td>
<td>Identity theft</td>
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  - Money Laundering
  - Claim fraud
  - Identity theft
Solvency...

*Depends on the observation of assets and liabilities*

- Reliable market
- Assets = Liabilities
  - Needed capital to underwrite risks
  - Excess capital
  - Economic capital =
    - Regulatory capital,
    - Risk capital, Excess capital
    + Solvency margin,
    Rating capital
Solvency…

*Watch out the volatility of economic capital!*

Assets = Liabilities

- **Unexpected claims**
- **Economic capital**

Market shortfall

Expected profits & losses are within best estimates. Unexpected developments lead to risks and need to be managed.
Customer Focused Engagement

- **Traditional** data warehouse methodologies are not an appropriate starting point for this type of solution.

- Focus must be on identifying tangible business benefits with real financial return of a value to justify a business case.

- The business case must make recommendations which recognise the current status, complexity and business imperatives of customers.

- This approach provides a strategic migration route for a financial organisation from a heterogeneous to a homogenous data architecture, independent of underlying data and technical architecture.
The Business Case

The business case must consider:
- Economic Advantage
- Risk reduction
- Tangible goals and objectives
- Management & maintenance
- Affordability
- Delivery and Stakeholders
- ROI
  - Tangible returns
  - Incremental revenues
  - Return on capital
  - Cost of capital

Tangible Objectives?
- Effective, efficient and enhanced hedging in light of IFRS rules
- Fraud Prevention
- Risk based pricing
- Cost of capital
- Alignment of operational practices with strategic plan and
  - …
Compliance Solution

Tangible financial benefit

Data represents more than 70% of the challenge our customers are facing

Identification of economic imperative and required data

Identification of **data requirements**.

Discovery and **planning extraction** of required data, modelling of benefits against actual data.

Plan and **implementation of compliance repository** using the Business Intelligence Framework.
Business Challenges or Opportunities?

- **Risk Management / Regulations**
  - Underwriting / Pricing / Margin
  - Life Time Value
  - Claim handling / Fraud
  - Asset Liability Management
  - Re-Insurance
  - Alignment of Accounting Standards
  - Corporate Governance

- **Customer Intelligence**
  - Speed to market
  - Profitability – Customer / Product / Channel
  - Growth Product Mix

- Agent Extranet
- Bancassurance
- […]

(Solvency II, Sarbanes Oxley, IFRS)
Effective Approach

Customer Understanding → Risk Understanding

Instrument Pricing

Capital Allocation

Risk Appetite → Compliance → Profit
Internal model of insurance company, users

ERM

Risk factors

Policy portfolio

insurance products

Sales structure

Investing funds

Assets portfolio

Reinsurance products

Chief Financial Officer
Corporate strategy planning and monitoring
Capital management
Analysis of factors influencing the global company's value

Chief Risk Officer
Integrated risk modeling
Analysis of risk exposition and impact of risk hedging

Reinsurance Manager
Adequacy of reinsurance contracts
Financial reinsurance

Actuary
Pricing, profit testing, product development
Reserve adequacy
Asset Liability Modeling
Solvency

Sales Manager
Analysis and development of risk portfolio (risk diversification, Customer Life Time Value)
Analysis of alternative commission systems (given certain profit level)
Adequacy of sales force structure

Chief Investment Officer
Analysis of alternative investment strategies
Insurance Intelligence Solution

SAS Insurance Intelligence Solution

Management solutions

Enterprise Risk Management

Product development

Pricing & Profit Testing

Sales Force Automation

Campaign Management

Portfolio management

Reserving

Reinsurance Profiling

Fraud Detection

Analytical applications

Customer Segmentation

Cross-Sell and Up-Sell

Customer Retention

Claims Prediction

Fraud Recognition

Analytical model

Data model
Enterprise Intelligence – it’s about business integration
To deliver your business strategy
Powered by an enterprise platform