What's next for Japanese insurers:

Ten imperatives for 2023

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Foreword

According to PwC’s 26th Annual Global CEO Survey, despite overall pessimism about global economic growth in 2023, Asia Pacific CEOs are more optimistic about growth in the region. They see upskilling, automation, digital and cloud transformation, rebalancing supply chains and decarbonisation as their top investment priorities. The Japanese economy and financial service industry are also at a crossroads as Japan’s central bank, the Bank of Japan (BOJ) considers inflation and monetary policies. Despite the underlying uncertainties, Japanese insurers must continue their transformation in order to remain competitive and grow globally. In this article we describe ten imperatives for Japanese insurers in 2023 as they try to transform themselves while navigating the challenges of today.

Industry context

In a world that is still recovering from COVID-19, dealing with inflation and high energy costs, coping with tightening monetary policies by major central banks, and facing an ongoing war in Ukraine coupled with increasing geopolitical tensions, it is no surprise that financial markets are in a state of chaos that is creating tremendous volatility. The International Monetary Fund (IMF) expects one-third of the world to be hit hard by recession in 2023, and lead economists of two-thirds of the major banks in the US agree on some level of recession in 2023. This environment, while challenging in many aspects, also presents an opportunity for the insurance industry.

Beyond the macro factors, insurers in Japan need to consider a number of market-specific developments that will have a significant impact on the industry in 2023.

Interest rate: The BOJ's decision in December to widen the allowance band around its yield target, while positioned as a move to 'continue the implementation of sustainable quantitative easing', surprised the public and jolted the market. With the upcoming changes in BOJ governorship and the potential impact on future monetary policies, we can expect volatility in bond and equity markets and investment returns. Insurers need to be prepared for the upcoming changes and resulting impacts on their products, pricing, profitability and capital management.

Solvency regime: The Financial Services Agency of Japan's (JFSA's) adoption of insurance capital standards (ICS) by 2025 will force insurers to navigate complex and at times conflicting accounting and solvency regimes. These changes in the capital markets can make it difficult for insurance companies with large assets to achieve both returns and asset and liability management under these requirements. We can expect regulatory focus and tension in balance sheet management, reinsurance transactions and implementation of ICS by 2025.

Decreased information asymmetry: Insurers can expect JFSA to strengthen point-of-sale disclosure requirements, especially around commissions, fees and coverage. In order to avoid negative customer sentiment, insurers and distributors will need to establish real trust with their customers.

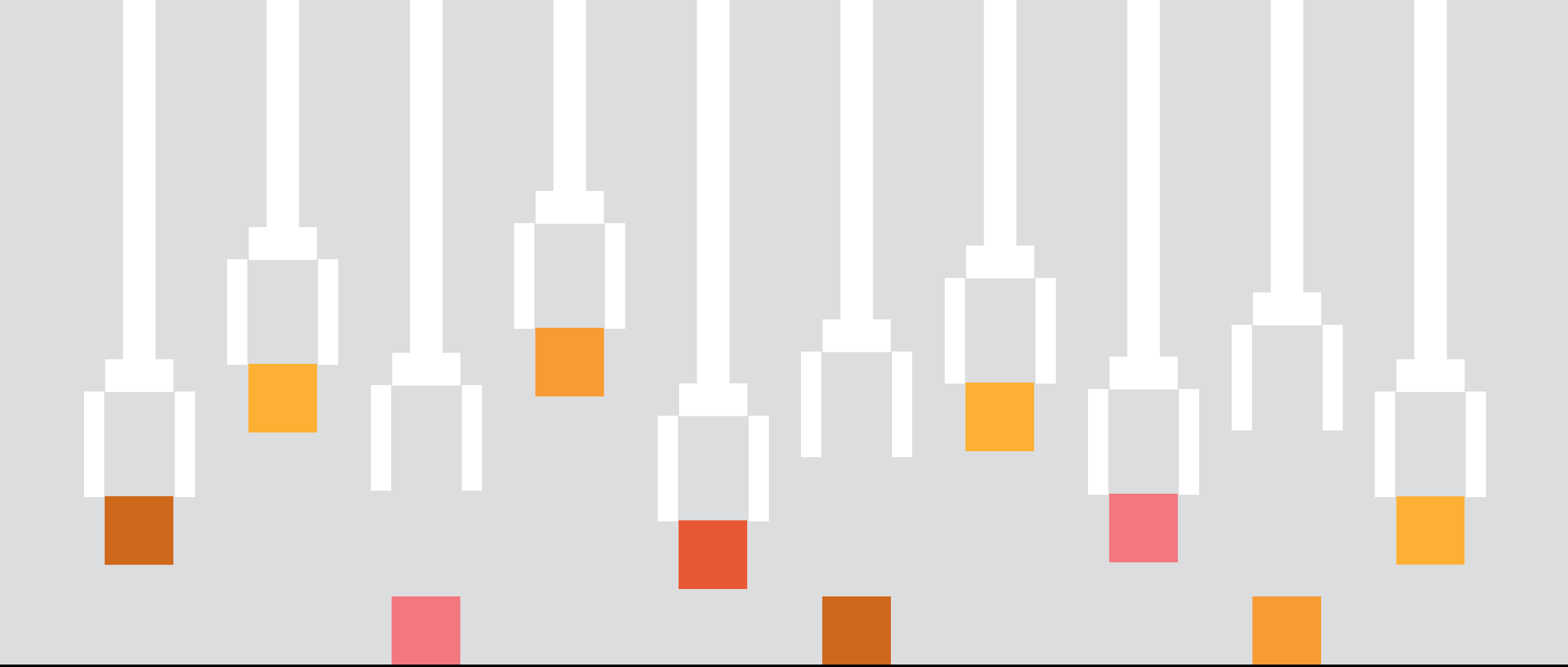
Global inflation: For non-life insurance companies that operate globally, supply chain issues and soaring materials prices will have a significant impact on their business.

New entrants from different industries: Consistent with global trends, Japan is also going to see new market entrants providing distribution and insurance offerings. The use of ecosystems and embedded insurance offerings to collaborate with and/or compete with these new entrants will be important for many insurers in Japan.

Demography and talent: With both birth and death rates declining in Japan, almost 30% of its current population is 65 or older. This creates two distinct challenges for Japanese companies: first, how to serve various generations, especially the aging population, and second, the availability of the talent they need to succeed in a digital economy.

Japanese insurers are not entering 2023 from a position of strength. In the first half of FY2022, results for most insurers have been disappointing, with significantly lower operating profit and net income in spite of higher premium income.
This can be attributed to a multitude of reasons, including COVID-related losses, natural disasters both inside and outside Japan, investment losses, and an inability to capture cost efficiency and productivity gains from digital investments.

So how should insurers in Japan approach 2023? Here we describe ten imperatives around five strategic themes that insurers must consider as they realign their strategy and investments.



Ten key imperatives around five strategic themes

Strategic themes	Key imperatives
A Value creation in deals	1 Maximise synergy and value from recent and past deals 2 Take advantage of lower valuation to find deals abroad
B Continued focus on digital transformation	3 Drive productivity and reduce operating expenses through digitisation 4 Continue to invest in modernising legacy platforms and introducing cloud technology 5 Mature data management capabilities
C Innovation and growth	6 Explore new revenue sources 7 Build solutions for the aging population
D Trust and sustainability	8 Leverage the economic solvency regime (ESR) and ICS to modernise risk and finance 9 Step up sustainability efforts
E Talent development	10 Upgrade and upskill talent

Ten key imperatives around five strategic themes

A. Value creation in deals

1 Maximise synergy and value from recent and past deals

Japanese insurers have engaged in a total of 88 M&A transactions (both within Japan and outbound) between 2018 and 2022.[1] While M&A is a key part of the growth strategy of major insurers in Japan, they have not done enough work to maximise the value from their past transactions. From aligning products, channels and services between similar business lines to leveraging capabilities and talent between operating units and geographies, in addition to simplifying operating models to drive cost efficiency, much to be done to create value from the past investments. Notwithstanding the complexities of some of these undertakings, it's a strategic imperative for the insurers to make it a top agenda for 2023.

2 Take advantage of lower valuation to find deals abroad

According to PwC's 'Global M&A Industry Trends: 2023 Outlook',[2] while economic and geopolitical uncertainties have created headwinds, they have also generated opportunities. A valuation reset, the availability of capital and the increased competitiveness from corporates should provide openings for dealmakers in the year ahead. Buyers with a strong balance sheet who do not rely on debt financing will be able to take advantage of lower valuation opportunities. While a weaker yen poses a challenge against a stronger dollar, certain sectors in the US, Southeast Asia and India should be on the prime shopping list for Japanese insurers. InsurTech valuations have also come down significantly in 2022, with US-listed InsurTechs down by an average of 50%.[3] This creates an attractive market for Japanese insurers to take a stake in InsurTechs as a way of augmenting their capabilities or their markets, products and channels.

Sources:

[1] Refinitiv's M&A data for the past five years (1 January 2018 – 31 December 2022). Analysis by PwC.

[2] PwC's 'Global M&A Industry Trends: 2023 Outlook'. https://www.pwc.com/gx/en/services/deals/trends.html

[3] PitchBook, Cap IQ. Analysis by PwC.

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B. Continued focus on digital transformation

3 Drive productivity and reduce operating expenses through digitisation

Compared to the US, Germany and China, Japanese companies report significantly lower improvement in productivity from their digital efforts. According to a 2022 study by the Ministry of Internal Affairs and Communications (MIC), 30% of Japanese companies report not having achieved digitisation benefits compared to 8% in the US and 5% in China.[4] One primary reason, in our experience, is that technological changes are not driving fundamental changes in business processes, policies and workflows, which makes it difficult to achieve return on investment (ROI).

Japanese insurers suffer from higher operating expenses compared to their peers outside Japan due to inefficiencies in their business processes and operations. Paper-based workflows with significant manual interventions still dominate insurance processes in Japan, resulting insignificant inefficiencies and higher labour costs. With the advancement of data utilisation and AI technologies, Japanese insurers must commit to eliminating paper-based processes from their workflow and building intelligent automation to minimise their reliance on manual work and to keep up with their global peers.

4 Continue to invest in modernising legacy platforms and introducing cloud technology

Part of the digitisation journey for insurers is modernising their legacy platforms and migrating to cloud native architecture. Technology investments by Japanese insurers are expected to grow by a compound annual growth rate (CAGR) of 4%[5] between 2021 and 2026, and a significant portion of this budget is expected to go towards cloud-based modernisation. In addition to driving improved customer and distributor experience, productivity and agility, this transition is essential to ensuring the competitiveness and innovation insurers need to succeed in a fast changing environment. Insurers will need to rethink their businesses, operating models, organisational structures and talent in order to achieve their desired outcomes.

5 Mature data management capabilities

Insurance is primarily a data business, but insurers are generally not good at capitalising their data assets for growth. With regulatory bodies relaxing regulations on the usage of data by insurers for non-insurance purposes, insurers have a wide variety of opportunities available to them. However, poor data integrity and the complexity of integrating internal and external data make it costly. With property and casualty (P&C) insurers taking the lead, we're finding that more insurers are taking steps to redesign their data architecture and data flow as part of a greater strategy to strengthen their data management capabilities, with the ultimate goal of enabling them to generate deeper insights needed to identify new sources of customer value, innovate products and services and deliver superior customer experience.

Sources:

[4] Ministry of Internal Affairs and Communications (MIC) - Research and development report on the latest information and communication technology in Japan and overseas, as well as research results on trends in digital utilization.

[5] IDC. Analysis by PwC.

Ten key imperatives around five strategic themes

C. Innovation and growth

6 Explore new revenue sources

Insurers across the globe are searching for new ways to create value and new sources of income. We see four strategies most relevant for Japanese insurers:

i) Create alternative ways to engage with new customers through embedded insurance and ecosystems (e.g. mobility, health).

ii) Leverage advances in IoT, AI and other digital technologies to go beyond protection into personalised risk prediction, prevention and intervention (e.g. healthy living, pay as you go, on-demand and parametric insurance).

iii) Address new risks (e.g. underserved segments, climate, cyber and digital assets).

iv) Explore Web 3 opportunities (e.g. metaverse, crypto and decentralised finance (DeFi)).

Insurers must have a strategic roadmap for addressing these new and evolving opportunities.

7 Build solutions for the aging population

With over 30% of Japan's population being 65 and older and more than 50% of all wealth trapped in this segment, there is a significant opportunity for insurers to play many roles in addressing the needs of Japan's aging society. From preventative health and wellness to elder care, long-term care, annuity and wealth transfer solutions, life insurers are well positioned to address many needs of this growing segment. Creating integrated health and wealth offerings alongside their traditional protection business is the next frontier for life and retirement players.
P&C insurers also can play a significant role as society needs to rethink the living and mobility needs of this segment.

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D. Trust and sustainability

8 Leverage the economic solvency regime (ESR) and ICS to modernise risk and finance

After years of deliberation, JFSA announced an outline of ICS-based rules and regulations to be adopted by April 2025. JFSA is expected to collect more economic, financial and risk information from insurers to develop a forward-looking view. Much work is needed to ensure a smooth transition from the current regime to an economic value-based regime.
This also creates an opportunity to for insurers to take a holistic approach to modernise their risk and finance functions. Many European insurers have leveraged Solvency II to modernise and transform their finance functions, and Japanese insurers now have the opportunity to take these much-needed steps as well.

9 Step up sustainability efforts

In November 2022, JFSA proposed a set of extensive revisions to the disclosure requirements regarding sustainability, human capital and diversity, and governance. While the requirements are yet to be finalised, insurers will need to comply with any current or pending regulations and disclosure requirements, including capturing, gathering, processing and reporting sustainability data by using the proper controls and governance.

While most Japanese insurers have taken several steps to promote ESG and sustainability, these activities are often disjoined or focused on compliance as opposed to a foundation for value creation. European insurers, as leaders in ESG and climate sustainability efforts, are taking a comprehensive approach while considering sustainability initiatives, including brand position, profitable growth, net carbon impact and ESG regulations. Japanese insurers have the financial and technical strength to lead ASEAN in ESG efforts, but that would require them to take a strategic approach and embed ESG in their core strategy and value proposition.

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E. Talent development

10 Upgrade and upskill talent

With digital technologies at the core of the future of insurance business, insurers need digitally savvy employees across the board, not just in their technology departments. Furthermore, as insurers need to plan for a shortage of talent in the market, reimagining the future of work and the workforce will be critical. According to PwC's 26th Global CEO Survey, 73% of Asia Pacific CEOs named 'Upskilling the company's workforce in priority areas' as their top priority.[6]

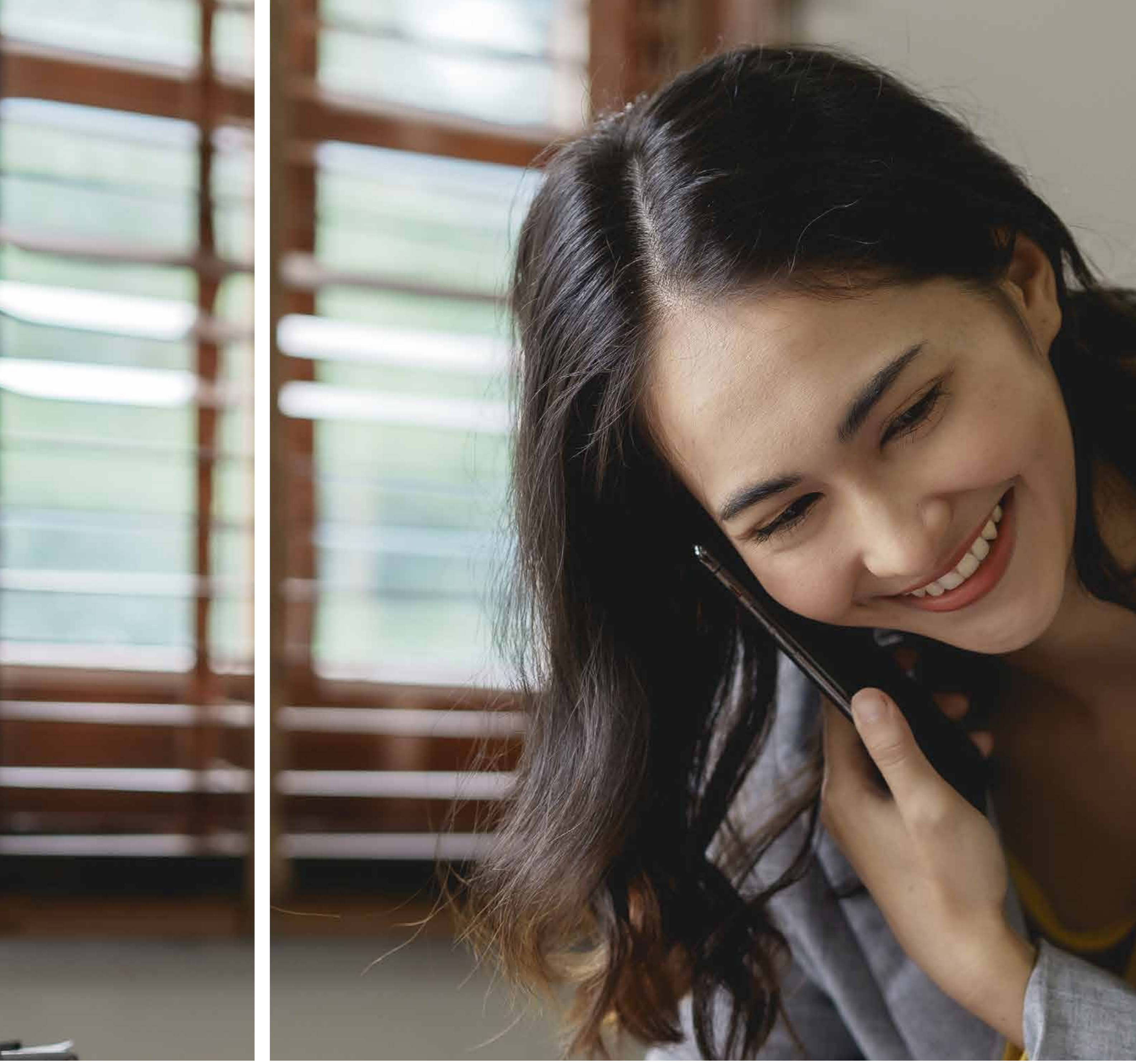
Based on our observation, the average digital skill maturity of Japanese insurers is below that of their global peers. Almost 68% of Japanese financial services companies report a shortage of digitally skilled workforce, and 40% report they do not have a system for upskilling talent.[7] A talent strategy aligned with the future of work needs to be supported by a comprehensive upskilling and assignment approach, especially for their long-term employees.

According to PwC's Global CEO survey, 40% of global CEOs think their organisation will no longer be economically viable in ten years' time if it continues on its current course. CEOs and other top leaders will need to reinvent their businesses against the backdrop of global financial, economic and geopolitical uncertainties. The priorities outlined in this report will allow Japanese insurers to navigate the volatility of today's environment and set up their organisation for future success.

Sources:

[6] PwC's 26th Annual Global CEO Survey. https://www.pwc.com/ceosurvey

[7] Ministry of Internal Affairs and Communications (MIC) - Research and development report on the latest information and communication technology in Japan and overseas, as well as research results on trends in digital utilization.



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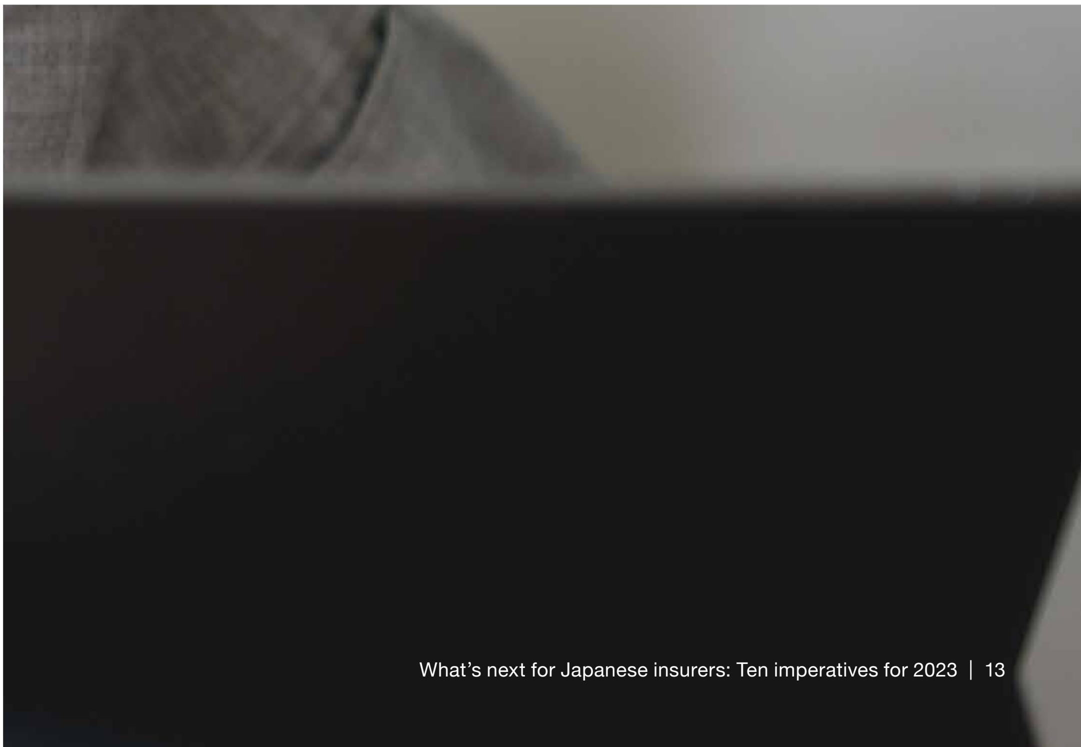

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