



What's next for Japanese insurers:
Ten imperatives for 2024



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Foreword

According to PwC's 27th Annual Global CEO Survey, CEOs around the world are more optimistic about global economic growth than they were last year while recognising inflation and macroeconomic volatility as primary threats to their companies. In Japan, as the Bank of Japan (BOJ), the central bank, examines inflation and monetary policies, the financial services industry is at a crossroads in anticipation of a world with positive interest rates, which many current businesspeople have never before experienced. In this fast-changing environment, Japanese insurers must continue to transform in order to maintain competitiveness and grow globally. In this article, we explain ten imperatives for Japanese insurers in 2024 as they work to transform themselves while overcoming today's challenges.



Business environment of the insurance industry

The possibility of stable inflation and higher interest rates is drawing attention. As a result, insurers may be urged to address asset management and product pricing with caution. Also, the prospect that the Financial Services Agency of Japan (JFSA) will introduce the Insurance Capital Standard (ICS), coupled with the outlook for the economic environment, may help invigorate reinsurance transactions. Japan's population dynamics continue to pose medium- to long-term issues for insurers, requiring them to embrace challenges towards sustainable growth, including proactive digital investment.

Economic environment: As the inflation rate in Japan remained above 2% throughout 2023, observers point out that there is a greater possibility for the BOJ to change its policy and raise interest rates. In the insurance industry, while increases in interest rates boost profitability from asset management, they also have the potential to bring about changes in the pricing of insurance products. In addition, given that interest rate rises could influence the behaviour of customers when they make comparisons with financial products, evaluating that impact is essential. Furthermore, stock prices continue rising and hitting post-bubble highs. While stock prices cause asset values to rise, they also increase the risk of market volatility. Amid the growing trend towards reducing cross-shareholdings, it is necessary to examine portfolios while managing risk appropriately.

Social environment: In contemporary society, where social media is widespread, the phenomenon whereby part of a story is cherry-picked to receive greater coverage in a fundamentally different context can have a great impact on the credibility of insurers. Turning to population dynamics in Japan, the societal trends of ageing and declining birthrates are steadily advancing. As this trend cannot be expected to change over the short term, insurers need to transform their business processes while responding flexibly to customer needs. The uncertainty in the international order and geopolitical risks resulting from prolonged international conflicts could potentially impact the insurance industry. This could pose additional challenges for insurance executives in steering their companies effectively.

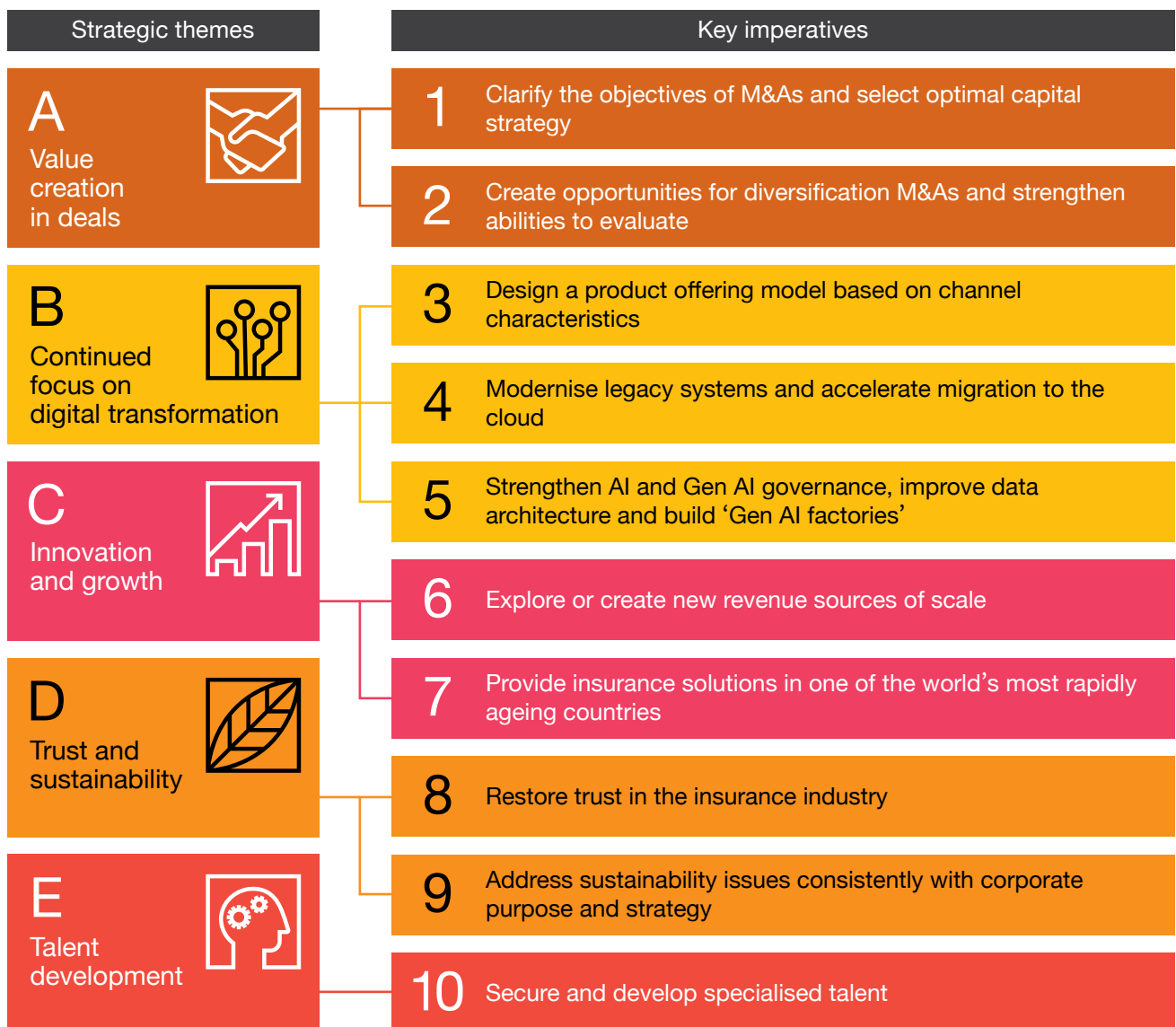
Regulatory environment: Given that the JFSA is expected to introduce the ICS by 2025 and that interest rate hikes are anticipated, reinsurance transactions may be advanced to accumulate reserves and avert the capital burden from interest rate risk. Because the authorities have no direct involvement with reinsurance transactions, autonomous risk management is important. Also, entry into other industries, which has recently been increasing, may diversify the types of regulations insurers must comply with, suggesting the need to reevaluate that risk. Moreover, 2024 is a presidential election year in the United States. While changes in US policies are expected, the direction is unclear, which could make management more difficult.

Technology environment: Owing to its use of natural language, generative artificial intelligence (Gen AI) may expand the potential for the mass use of AI and boost automation and data processing capabilities. At the same time, it has the possibility of creating challenges such as the protection of personal information and the transparency of models. There are also concerns that the existence of host systems using old programming languages may hinder innovation and increase security risks. Furthermore, although it will likely become important for insurers to effectively manage large quantities of data and gain insights, they must also pay attention to data quality and privacy issues. Overall, it is essential for insurers to combine appropriate security measures either in the maintenance of old technologies or in the introduction of new technologies.

Since the start of 2024, Japanese insurers have been seeking out the next challenge, driven by tailwinds of the recovery from the COVID-19 pandemic and the economic environment. Cash flow generated from diverse activities can be allocated to new investment, in addition to being returned to shareholders and policyholders. How should Japan's insurers approach 2024? In this article, we explain ten imperatives around five strategic themes that insurers must consider as they realign their strategies and investments.



Ten key imperatives around five strategic themes





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A. Value creation in deals

1 Clarify the objectives of M&As and select optimal capital strategy

Between 2020 and 2023, when activities stagnated due to the COVID-19 pandemic, Japanese insurers were engaged in diverse mergers and acquisitions (M&As), both domestically and overseas. Globally, record-high deal activities took place from 2021 through 2022, although a deceleration was seen in 2023 due to concerns regarding inflation and interest rates¹.

In 2024, the deal market for insurers may be stronger, led by the insurers and private equity firms with ample capital. For Japan's leading insurers, M&As will remain an important factor to create growth and operational synergy on a global scale. M&As are also expected to make a positive contribution to corporate value through the reduction of costs, the expansion of market share and other benefits. Japan's insurers may continue to exhibit their presence on the M&A market but may have issues with the discipline of exits from the perspective of portfolio management for the optimal capital structure.

The introduction of the ICS in Japan is expected to increase transparency regarding the financial soundness of insurers while leading to various transactions, including reinsurance. Legacy block transactions may help insurers concentrate on core growth areas by freeing up capital and management resources. For Japanese insurers, the strategic issue is how to form portfolios and conduct effective transactions to achieve their overall goals.

2 Create opportunities for diversification M&As and strengthen abilities to evaluate targets

Insurers acquire not only insurance businesses but also asset management companies and other services companies (e.g. healthcare businesses). Entering different industries and markets allows for diversification of revenues and enhances resilience against economic downturns and the intensification of competition.

A growing number of insurers think that fee-based businesses diversify the risk of the insurance business and contribute to the stabilisation of financial performance. On the other hand, it may create new challenges including: the difficulty of integration due to differences in industry and culture, increases in unexpected business risk, and complexity in the appropriate allocation of the necessary capital and management resources. When embarking on such transactions, strategic planning, sufficient due diligence and the drafting of integration plans are essential.

In particular, to successfully carry out M&As for diversification, it is imperative to consider the balance between risk and return and to select transactions that are consistent with long-term growth strategy. More importantly, decisions on these matters should be made after ensuring transparency with solid corporate governance.

¹ PwC, 2023. 'Global M&A Trends in Financial Services: 2023 Mid-Year Update' (Japanese only) (<https://www.pwc.com/jp/ja/knowledge/thoughtleadership/dealsinsights/deals-trends2023-mid-year.html>).



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B. Continued focus on digital transformation

3 Design a product offering model based on channel characteristics

Prompt product development to quickly respond to customer needs is pivotal both to insurers that supply their products to agencies and to insurers that try to incorporate asset management needs. Also, advancing swift product development in the embedded insurance field enables seamless integration with noninsurance services and facilitates the expansion of sales channels and enhancement of customer experience.

These activities, which require insurers to accurately grasp customer needs as a major prerequisite, contribute to long-term success in the rapidly changing industry. Whereas data utilisation provides macro information on individual customer needs, how this information is utilised emerges as differences in the level of management skills. What continues to be important to insurers' strategies is to provide sufficiently persuasive information to the JFSA without overlooking customer needs and thereby smoothly advancing product approval programmes.

4 Modernise legacy systems and accelerate migration to the cloud

Modernising legacy systems and utilising cloud computing is an issue that Japanese companies are struggling with. The Digital Transformation Awareness Survey^{2,3} on Japanese companies conducted by PwC in 2022 and 2023 indicates that, although corporate use of the public cloud is increasing, companies tend to restructure systems within the present environment. This can be seen in the updating of existing systems and upgrading of large-scale systems still implemented on premises. Modernising legacy systems is the key for Japanese insurers to respond to dynamic changes in customers, technologies and regulations. Individual insurers show a stance towards actively digitalising online services, automated claims processing and data analysis. However, linkage with and development restrictions caused by old system technologies typified by the COBOL programming language become bottlenecks.

The reality is that Japanese insurers have not been able to embark on bold reforms, including operations, primarily because of the difficulty of replicating

operational requirements, the complexity of handling customer information in data migration and high technology migration costs. They have to take actions that consider the balance of risks and costs, for example, by introducing new workflows from new programmes while simplifying and standardising current processes. In facing such difficult issues, the objectives of reform are of considerable importance. To fulfil the obligations under insurance contracts into the next generation, swiftly adapting to various types of change will be vital over the next few years. In addition to reforms presuming the continuation of existing business models, turning insurance functions themselves into services as represented by the concept of Insurance as a Service will become a vital guidepost for reform.

5 Strengthen AI and Gen AI governance, improve data architecture and build 'Gen AI factories'

Gen AI has the potential to bring about a revolution to productivity within insurers. Gen AI will make it possible not only to streamline various aspects of the industry but also to reinforce them and make them more efficient by harnessing its advantages as general-purpose AI. In the underwriting business, Gen AI can support risk assessment by quickly and precisely analysing large data sets, thereby facilitating faster and more accurate decision-making. In claims processing, it can automate daily tasks to reduce manual labour and minimise errors.

Furthermore, Gen AI can help develop personalised insurance products by analysing individual customer data and adjusting the range of coverage to meet specific needs. In customer services, chatbots run by Gen AI can provide immediate support, efficiently resolve inquiries and boost overall customer satisfaction. This can increase business agility and competitiveness through a wide-ranging proactive approach that is difficult to achieve manually. Gen AI can also contribute to fraud detection by identifying patterns indicating suspicious activities and protect insurers from economic losses.

By introducing Gen AI technology, insurers can raise operating efficiency, reduce costs, provide more responsive personalised services and remain on the front lines of innovation in the ever-evolving insurance industry.

² PwC, 2022. 'The Digital Transformation Awareness Survey 2022: IT modernisation survey' (Japanese only) (<https://www.pwc.com/jp/ja/knowledge/thoughtleadership/it-modernization-survey2022.html>) .

³ PwC, 2023. 'The Digital Transformation Awareness Survey 2023: IT modernisation survey' (Japanese only) (<https://www.pwc.com/jp/ja/knowledge/thoughtleadership/it-modernization-survey2023.html>) .



Ten key imperatives around five strategic themes

C. Innovation and growth

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Explore or create new revenue sources of scale

For the business continuity and expansion of insurers, a certain scale is important to achieve cost efficiency, risk diversification and to monetise innovation opportunities. At leading Japanese insurers that already generate a substantial scale of profits each year, new revenue sources must have a suitable scale.

Geographically, there is growth potential in emerging markets in Asia, Latin America, Africa and elsewhere. Also, even in mature markets like Japan, as cyber insurance and other new types of insurance products have been on the rise in recent years, there is believed to be potential to expand scale in untapped market segments.

In addition, changes in industrial structures are causing the insurance industry to undergo a significant transformation. There emerge many important themes that could impact the revenue base and, at the same time, become new revenue sources—most notably, the progress of autonomous driving technologies and the wider adoption of electric vehicles for the property and casualty insurance (P&C) industry, and the individualisation of health and medical needs and higher health care costs driven by advances in drug discovery and medical technologies for the life insurance industry. Whereas insurers have grasped demand based on the customer needs identified from existing sales channels, it may be an important consideration to seek out business models whereby insurance functions can play a key role in the ecosystems of other industries and business categories.

7

Provide insurance solutions in one of the world's most rapidly ageing countries

In Japan, which is one of the world's most rapidly ageing countries, providing insurance solutions for an ageing society is crucial. As the absolute number and percentage of the elderly population increase, unique risks and demands emerge in medicine and nursing care, among other fields. Insurance provides financial stability to retirees and their families. It covers high expenses such as facilities and home care for the elderly, medical expenses and other costs that exceed public support and are increasing every year.

These activities not only contribute to the welfare of the elderly, but also, depending on the type of involvement, may financially support the social security system and provide free time to workers who are family caregivers. The Japanese insurance industry even has the potential to help extend healthy life expectancy and create a sustainable society. It has the promise to become an exemplary business model for other countries where the age of society will continue to advance.



Ten key imperatives around five strategic themes

D. Trust and sustainability

8 Restore trust in the insurance industry

Promoting ethical business, addressing the industry's cartel problem, and preventing fraudulent claims and solicitations are critical to maintain trust in the insurance industry. Policyholders expect insurers to protect their interests; however, as social expectations rise, the difficulty of insurers in meeting the trust of policyholders is increasing.

The loss of trust damages the foundation of the industry that is built on mutual assistance. Hence, it becomes important to behave from the standpoint of wide-ranging stakeholders including not only policyholders and shareholders, but also employees, business partners and local communities. Because of their complexity, insurance contracts are sometimes subject to simple comparison with products like mutual funds without a sufficient explanation of how insurance functions. Insurance sales based on such misunderstandings may contribute to the top line over the short-term, but over the middle- to long-term, such activities could harm company finances and also result in a loss of trust from society. This is clear because of the painful experiences the insurance industry has suffered many times in the past.

9 Address sustainability issues consistently with corporate purpose and strategy

Insurers and economic forecasters continue to analyse economic losses stemming from extreme climate events. Some research, utilising hypothetical systemic risk scenarios, calculates US\$711 billion as the expected global economic loss from such events over the next five years⁴.

This impact will not be limited to P&C insurers alone. In particular, a scenario characterised by large emissions of greenhouse gases assumes that life insurers will also need to deal with the potential rises in mortality and morbidity caused by climate change.

While only a few organisations are boldly realigning their business portfolios, products, services and functions in line with the opportunities that emerge from sustainability issues, recent regulations, including the European Union's Corporate Sustainability Reporting Directive and the US Securities and Exchange Commission's climate-related disclosure rules, will likely encourage more companies to examine the strategic and financial impact of sustainability. This presents a unique opportunity for insurers to address social problems that will have a large impact on future generations and to manifest leadership.

⁴ Lloyd's, 2023. 'Lloyd's new data tool highlights vulnerability of the global economy to extreme weather' (<https://www.lloyds.com/about-lloyds/media-centre/press-releases/lloyds-new-data-tool-highlights-vulnerability-of-the-global-economy-to-extreme-weather>)



Ten key imperatives around five strategic themes

E. Talent development

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Secure and develop specialised talent

Insurance is a business that relies on large numbers of human resources. Operations such as insurance underwriting and claims payments require considerably wide-ranging knowledge, skills and experience. The presence of a sufficient number of superior personnel helps maintain the credibility of the industry and the competitiveness of individual companies. The insurance industry has retained superior personnel with high salaries and other benefits, but now faces an unprecedented competition for talent. Attracting and retaining talented personnel is essential for the continuity of innovation and business growth. As such, securing human resources is a critical foundation for the success of insurers. Although annual salaries and other obvious factors tend to be reported in the media, outstanding talent may emphasise not only annual income but also nonmonetary factors—namely, whether a company is worth spending their time on in terms of self-realisation and social impact, and whether an industry has a future.

Another important issue is the reeducation and upskilling of employees to boost productivity in an environment driven by digital technologies and AI. According to PwC's Global Workforce Hopes and Fears Survey 2023, whereas 36% of employees believe that the skills required for their jobs will change significantly within the next five years, only 43% have a clear sense of how the required skills will change. Although many insurers have launched programmes for the reeducation and upskilling of their employees, these initiatives must be further accelerated to prepare the insurance workforce for the next ten years. Insurers are in a unique position in the sense that they incorporate trust and social goals in the employee value proposition to attract and retain future human resources. Constructing progressive human resources functions in line with the organisation's future vision is the starting point.

⁵ PwC, 2023. 'PwC's Global Workforce Hopes and Fears Survey 2023' (<https://www.pwc.com/gx/en/issues/workforce/hopes-and-fears.html>)

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This report is a translation of '日本の保険事業者が知っておくべき「2024年の必須課題」トップ10', originally published by PwC Japan Group in June 2024. Although we have made every effort to provide an accurate translation, in the event of any differences in interpretation between this translation and the original, the original takes precedence.

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Publication date: June 2024 Control No: I202405-03

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