Top insurance industry issues in 2021
Alternative models
Rethinking purpose and structure

Insurers promise “we’ll be there when you need us.” In exchange for premiums paid today, buyers trust that they can rely on certain financial help if they face peril in an uncertain future. To reinforce that promise, insurers have to diversify risk, and scale helps them deliver on that promise. And, to some extent, they’ve been trying to fine tune the balance between centralized, standardized and controlled capabilities and decentralized models.

An insurer’s capital and reserves do have to be rock solid. But buyer attitudes and behaviors are changing. Once they’re assured that claims will be paid (one of the primary factors on which insurers are rated), customers probably care less about size than they once did. When policyholders think of a word to describe the typical carrier—with imposing headquarters, products sold through a bricks-and-mortar agency sales force and so on — many no longer pick the word “trust.” In a recent survey of US adults, just 37% of respondents indicated that they trusted the insurance industry “to do what is right” — behind some well-known internet brands that are known more for flexibility than heft.¹

Established carriers may still be able to outperform emerging rivals. But to remain relevant, they have to get past outdated assumptions about what it takes to succeed. Increasingly, we see industry leaders rethinking their purpose and looking to alternative business models, along with the need to think about their companies’ structure.

Here we look at a few ways that business is changing. However different the new models may be for property and casualty (P&C) versus life and annuity, there’s a common theme: In this environment, flexibility and responsiveness matter more than ever.

Restructuring the balance sheet

Do all the spinoffs and divestitures mean that insurance operating models are under stress? Yes. The distractions and inability to fund growth at scale, with interest rates at historic lows (see Figure 1), and capital pressure, are forcing companies to rethink their models. As some companies exit, others are stepping in, often with different drivers and broader revenue sources. Some asset managers, for example, have expressed interest in expanding their assets under management through deals with insurers. Two key factors are driving this trend: asset managers are generally able to generate a higher risk-adjusted return on assets and more assets under management drives additional fee income. For some of the same reasons, private equity firms have also pursued insurance company deals.

But it’s getting a lot harder to remain profitable with the traditional model. For many insurers, the key may be in becoming more flexible through a more sophisticated capital management structure.

Some companies may generate excess capital by ceding more business to reinsurers and others may set up new offshore entities or expand work with other companies to share risk in captive insurance arrangements. Over the next 12-18 months, we expect forward-looking insurers to aggressively reduce the capital intensity of their business as they make these kinds of strategic decisions. This could lead to some challenging questions as companies confront what their core business really is.

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Figure 1: Long-term (10-year) sovereign interest rates: Germany, USA, Japan

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<thead>
<tr>
<th>Year</th>
<th>Germany</th>
<th>USA</th>
<th>Japan</th>
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<tr>
<td>1995-01</td>
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<td>2020-01</td>
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Rethinking product design: Adapting to pay-as-you-go

Most of today's insurance products are remarkably similar to those of a generation ago, underwritten with similar principles and sold through the same agents and brokers. But this static period could be coming to an end, led by the rise of usage-based insurance (UBI) and behavior-based insurance (BBI) policies.

Pay-as-you-go policies are still niche products, but they have attracted more attention during the pandemic. When people see their cars sitting unused for months, many wonder why they're paying for coverage they don't really need. Commercial tenants feel the same frustrations as they pay to protect unused office space. Other companies have had to manually adjust their workers' compensation coverage to reflect layoffs. There's a growing sensitivity to align insurance premiums with their perceived value.

In the early months of the pandemic, we saw some companies grant temporary rebates or refunds based on reduced risk exposures — sometimes at the behest of regulators. Most leading personal auto carriers have now introduced some sort of UBI/BBI program, though these tend to lean to offering discounts rather than recalculating premiums. Still, there are indications that new approaches are coming across the industry, and they could gain traction quickly with buyers who may feel that they're already paying for benefits they can't use. Meanwhile, even if revenue drops, insurers could see profitability increase as they use data more effectively to assess their true exposure.
Rethinking product design: New products, new requirements

In our 2021 CEO Survey, executives indicated that they will turn to new product launches as a major component of growth over the next year (see Figure 2). But launching an insurance product that’s truly new is very different from rolling out a new smartphone, and building insurance products that policyholders perceive to be priced more fairly could be particularly difficult. Still, you’ll want to avoid the temptation to follow someone else’s lead, because this one will take more time than you think. You’ll need to develop new technical competencies to do this, including different ways to assess, underwrite and price risk. You’ll need to incorporate real-time information and be prepared to update your assessments continuously. You’ll also need to assess how to market these products alongside your traditional offerings, given that premiums might drop — or you might choose to offer additional layers of protection for the same price, changing your products’ competitive positioning.

Figure 2: Companies look to new products for growth
Top priorities for US CEOs to drive growth over the next 12 months

Launch a new product or service

US: 63%
Global: 56%

Q: Which of the following activities, if any, are you planning in the next 12 months in order to drive growth?
Source: 24th Annual Global CEO Survey
Base: 260 US executives, 1,779 global executives (weighted proportionate to country nominal GDP), January to February 2021

Rethinking product design: Customizing coverage

While the shift toward UBI/BBI is likely to occur first in individual P&C policies, it's a logical fit across the P&C spectrum. We already see new and unique coverages throughout the inland marine market, and remote sensors could change the way companies evaluate risk for property in transit. These principles also apply more broadly, as accident and health (A&H) lines incorporate just-in-time coverage for travel and other defined behaviors. And in life and disability insurance, carriers are starting to get access to far more granular information about their customers’ true exposure, drawing on data from fitness trackers and smartphones. Business clients may be willing to share behavioral data that shows they've lowered their risk, though they may have some privacy issues to navigate. Carriers may determine that they can earn a greater return from charging less by uncovering new and growing markets — if they can do so without inviting adverse selection. Clearly, there’s a lot to learn here, and you’ll want to give yourself adequate time to understand how to adapt pricing profitably for the period of time in which your customers use your products. It’s not a good time to play catch-up.
Rethinking product design: Embracing fee-based services

It used to be a lot easier to earn healthy returns from premiums invested over time. But persistent low interest rates have affected investment portfolios throughout the industry subsectors. Capital-heavy life-annuity-group-retirement (LAGR) companies with long-tail risks have been hit particularly hard.

In [What US life insurers should do about low and negative interest rates](https://www.pwc.com), we noted that this closing vise has implications for strategy and sales, product pricing and in-force management, financial reporting and forecasting, balance sheet and capital, and enterprise and financial risk management. There has been intense pressure on publicly traded carriers to offer more attractive returns to shareholders. We expect many insurers will look for ways to step away from businesses that require so much capital as they rationalize their portfolio of businesses, cost-structure and even growth strategies. We’ve already seen carriers exiting non-core businesses through restructurings and divestitures. But when you start divesting the more capital-intensive products, you’ll need to determine where your future growth will come from.

We expect a number of companies will look for growth in fee-based businesses, reversing the age-old paradigm that insurance is sold rather than bought. They’ll need to find new ways to reach clients as they realign toward financial wellness and guidance. One promising path may be found in [the rise of insurance ecosystems](https://www.pwc.com), which can provide new ways of reaching customers who want to find out how they can live a fuller life — rather than how they can buy an annuity.

Mutual insurers and privately held carriers typically start with more flexibility than their public counterparts because their capital structure is more patient. They may begin to emphasize wealth planning over insurance and annuity products, in part because their typical client has a higher net worth. Whether they focus on financial health or estate and tax planning, we expect to see a number of companies redefining themselves in ways that go beyond traditional life and annuity products.

In P&C markets, this trend is still emerging. We’ve already seen insurers embedding natural complements like roadside assistance to their traditional policies, and carriers have been looking for ways to better monetize this capability and expand the services it could enable. Risk prevention and control is another promising area with the growing number of Internet of Things (IoT) sensors leading to a variety of new services like fee-based diagnostics. As ecosystems mature, we could also see some insurers move to a platform model, offering their core capabilities as a component of another firm’s service.

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Integrating with business partners

An industry colleague once observed that some people are uncomfortable shopping for insurance because the product category itself reminds them of their own vulnerability. One way insurers can address this is through nontraditional selling relationships. In Forces shaping insurance distribution, we highlighted efforts by P&C companies to embed their products in the new car and home sales processes. This can make the buying process virtually seamless, downplaying associations with potential loss.

But this trend is driven by data, not psychology, and it’s one more reminder of why the growth of the digital economy is one of the brightest spots in the current outlook for our economy (see Figure 3).

To support the alternative business models of the future, you’ll need to open your technology architecture to integrate differently, as is happening today with car manufacturers, home builders and a wide range of other businesses. Similarly, you’ll need to work far more effectively in one or more ecosystems, with the ability to share information in real-time with other product providers, channel partners and customers. They’ll also need to be prepared to ingest massive amounts of sensor data that are key to UBI and BBI coverage.

The key to effective underwriting is understanding behavior. With access to sensors that give information about how and when a driver uses a vehicle and how a homeowner uses and protects building systems, insurers can make far more informed decisions about risk. We’re seeing similar developments in the LAGR and small commercial P&C markets, where innovative insurers have teamed with payroll services providers and other business services companies.

This represents a big shift in the sector as many insurers prepare for new ways of designing and distributing products that their legacy systems just can’t handle. The issue is cultural as much as technical. Traditionally, insurers felt that they could engineer all the capabilities they might need to serve their customers. Now we’re in a much more rapidly changing environment, where even the largest carriers may not have enough money or time to build a closed system with the kinds of capabilities they need to serve customers before markets have moved on.

**Figure 3: Digital economy remains a bright spot in 2021**

Growth opportunities outweigh risk concerns for CFOs

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<thead>
<tr>
<th>Growth of digital economy</th>
<th>High risk</th>
<th>High growth</th>
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<tr>
<td>19%</td>
<td>46%</td>
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Q: How would you characterize the impact of these macroeconomic trends on your business model in terms of risk and growth opportunity?

Source: PwC US Pulse Survey, March 12, 2021: CFO base of 182

9 Ibid.
A time of adaptation and selection

There’s an argument that the insurance industry changes through a process known as punctuated equilibrium. This idea, borrowed from evolutionary biology, assumes that the way business is done is relatively stable for long periods of time. Then, in a burst of activity, there’s a period of relationships being broken up and natural selection taking place.

Punctuated equilibrium is apt here. Concepts like UBI and life insurers pursuing investment management aren’t new. But we now have a particular combination of enablers — new capital sources, redesigned products, tech platforms built for interactivity and different ways of thinking about talent — that wasn’t present until very recently. Taken together, these represent a threat to legacy industry participants — and a rare opportunity.

We’ve presented several different strategic paths that insurers might consider based on their sector, culture, core capabilities and resources. Just as 2020 served as an unexpected catalyst to some large changes to the way we work, more unpredictable disruption is inevitable. For insurers to thrive, they’ll need to cultivate the capability to assess, pivot, partner, connect and reinvent themselves.

As the industry experiments with new business models, you’ll want to quickly prioritize and explore the options that are most promising for your organization. You’ll need to free up capital to invest in new directions. You’ll want to explore different marketing messages so you learn what aspects of new product design will be most relevant to buyers. In other words, there’s a lot to do and not a lot of time to do it.

At a time when private equity capital is flooding into the industry and InsurTechs keep honing their offerings, legacy players are feeling the pressure. But we’re also seeing signs that leaders are preparing for this reinvention. Insurers have the domain expertise, the brands and many of the capabilities that give them the power to win. If they can build the flexibility to adapt to alternate business models, they’ll help new generations of businesses and families manage risk and pursue opportunity.
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Thank you