Accelerating Digital in P&C Insurance to Weather the Perfect Storm of Uncertainties

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Introduction

The Property and Casualty (P&C) insurance industry is in the midst of a perfect storm of challenges. Low profitability has been prevalent, particularly in the last several years. The rise of emerging insurance technology companies is creating steep, agile competition. Geopolitical unrest – such as Brexit and the Trump administration's proposed policy changes to the H1-B visa program, deregulation, and tax cuts – is causing significant uncertainty in the P&C insurance industry. The evolution of the customer base and their demands for access, communication, and new offerings through multiple channels and technologies will require dramatic changes to the way P&C insurers deliver services. And although business and IT support services in the P&C insurance industry are mature, optimizing operations continues to be an ongoing challenge.

But P&C insurers can turn this gloomy picture into blue skies of near- and long-term value by accelerating implementation and adoption of digital technology, in particular analytics, automation, and advanced IT.

This executive viewpoint provides an overview of the challenges and risks P&C insurers face today and explores several critical areas that will allow them to weather the storm of uncertainty and create a competitive edge.

Overview

Following are brief discussions of the key issues that are driving the need for change.

Weak profitability

Over the last several years, the U.S. P&C insurance industry has been characterized by sub-par premiums growth due to pricing pressures, a rise in claims losses due to a growing number of catastrophes, increasing fraud costs, and stagnant investment income due to low net yields on invested assets. For example, for the first three quarters of 2016[1], net written premiums grew at 2.8 percent compared to 4.1 percent for similar periods in 2015. Claims losses rose dramatically to 7.6 percent in 2016, compared to 2.7 percent in 2015, with a sharp increase of 34.3 percent in catastrophe-related claims, due to major storms such as "Superstorm Sandy."[2] Overall underwriting losses for 2015 were $1.7 billion, 2016 net investment gains dropped sharply by 11.6 percent (a decline of $5.1 billion) compared to 2015, and fraud costs are at $32 billion a year in the U.S.[3]

Heightened competition

InsurTech organizations are emerging as innovation drivers and the developers of disruptive technology solutions that are threatening the existing P&C insurance business model. InsurTech firms have found ways to leverage the Internet of Things (IoT) to gain access to large amounts of data to more accurately assess the impact on individual risk profiles. For example, by aggregating and analyzing data from sources such as social media, home security systems, and telematics, InsurTechs can create accurate individual risk profiles that allow for development of better product offerings and pricing. And these firms continue to receive billions in venture capital funding. In 2015, InsurTech start-ups raised $2.65 billion in capital, which was a 350 percent increase from 2014.[4]

Operations and internal IT

Despite ongoing efforts to optimize operations, P&C insurers continue to struggle with customer needs and retention, product innovation, speed to market, and cost control. Business process operations[5] in P&C insurance organizations account for 26% of the expense ratio[6] and employ 46% [7, 8] of the workforce.

1 "Beth Fitzgerald, Verisk Analytics, *Property/Casualty Insurers Report $1.7 Billion Net Underwriting Loss in Nine-Months 2016*, http://www.verisk.com/between-the-lines/january-2017/property-casualty-insurers-report-1-7-billion-net-underwriting-loss-in-nine-months-2016.html
2 Ibid
3 Insurance Information Institute, Insurance Fraud, http://www.iii.org/issue-update/insurance-fraud
4 Anik Sen and Dennis Lam, PineBridge Investments, *Insurtech: Disruptions and Opportunities in the Insurance Industry*, (September 2016), 1-4
5 Accounts for product development, new business management, policy servicing, and claims processing
6 Measure of profitability calculated by dividing the expenses associated with acquiring, underwriting and servicing premiums divided by the net premiums earned; Andrew Sebastian, Investopedia, *What is the expense ratio in the insurance industry*, http://www.investopedia.com/ask/answers/102915/what-expense-ratio-insurance-industry.asp
7 McKinsey, *Automating the insurance Industry*, http://www.mckinsey.com/industries/financial-services/our-insights/automating-the-insurance-industry?cid=eml-web
8 Excludes IT and business support functions

Most processes within support functions (e.g., policy issuance, policy servicing, and claims management) are still highly transactional and serviced manually, leading to longer claims processing cycle times, increasing fraud costs, compliance errors, and quality issues. These internal challenges continue to pressure margins and service quality, and consequently affect the overall customer experience.

Further, like other mature industries, P&C insurance organizations have amassed many complex legacy IT systems to support operations. Core IT systems are aging rapidly, requiring increased maintenance and specialist operating knowledge while offering limited flexibility. They lack capabilities to effectively integrate with social media, cloud, or mobile applications, inhibiting P&C insurers' ability to proactively combat fraudulent claims, optimize pricing, and enhance efficiencies. And they hinder business processes such as 24/7 straight-through claims processing, on-demand functionality, and analytics-driven insights, all of which have become table stakes in delivering better customer service.

Geopolitical uncertainty

The current geopolitical landscape (e.g., the Trump administration and Brexit) has left the P&C insurance industry shrouded in a cloud of uncertainty. While deregulation and expansionary fiscal policy may provide positive opportunities, job protectionism is a serious challenge that will require a new approach to traditional talent and sourcing strategies. Given continuous profitability pressures, P&C insurers have historically leveraged labor arbitrage through outsourcing and offshoring to reduce labor costs. In 2015, approximately 120,000 service jobs (i.e., mid and back office business and IT services) in the industry were offshored. While that number is modest compared to other industries, reshoring jobs will still negatively impact P&C insurers as FTE costs in offshore locations range from 19-67 percent less than onshore. With President Trump's proposed job protectionism mandate, current sourcing strategies may be in jeopardy, and U.S. insurers will need to find new ways to offset the negative operational and financial impact of moving these jobs back onshore. Insurers will also need to ensure they have access to the talent they need, aligned to changes in customer needs and technology-led business models. (*See exhibit 1, page 5*)

Changing customer profile and needs

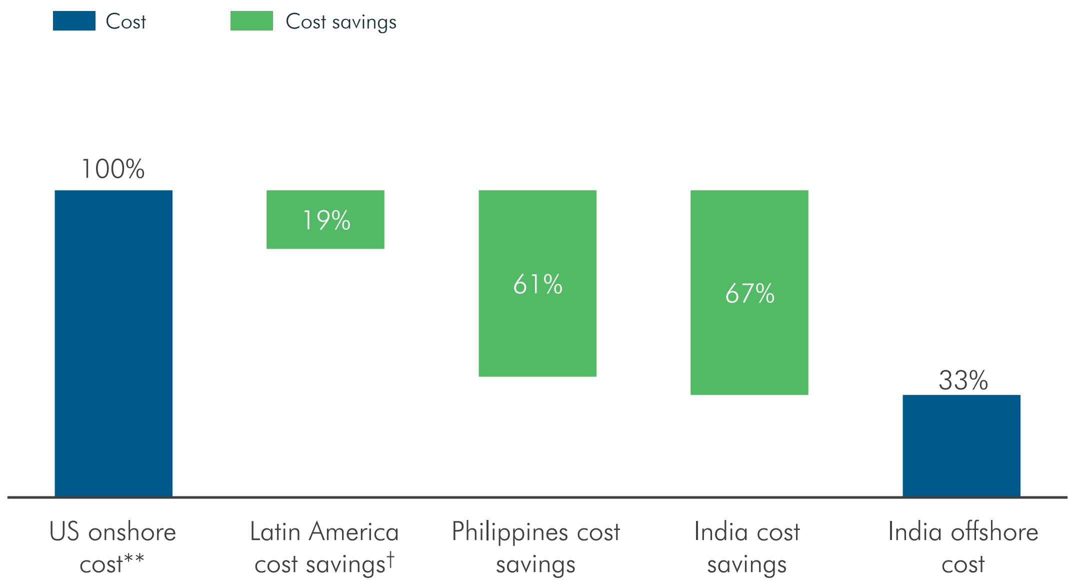
The P&C insurance consumer profile, what consumers require, and how they shop for insurance are rapidly changing. For example, Millennials accounted for over 75 million of the total U.S. population in 2015, while GenXers and Baby Boomers accounted for 74.9 million and 66 million, respectively. Thus, Millennials have become an increasingly important target market for P&C insurers. (*See exhibit 2, page 5*)

EXHIBIT 1

Percentage of U.S. onshore labor cost

Source: Everest Group

Offshore labor cost savings*



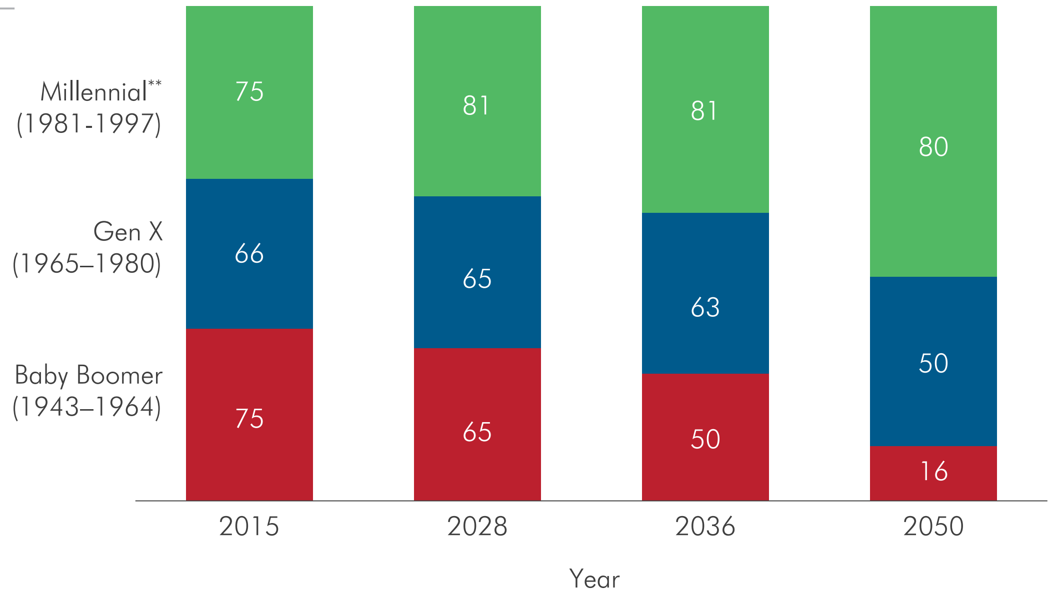
* Based on the average annual cost per FTE for AO services; Based on average of low and high wage range
** U.S. cost is 3x the cost of an FTE in India
† Accounts for Argentina, Brazil and Mexico
Note: Does not include training, relocation, benefits, etc.

EXHIBIT 2

Millions of people

Source: [Pew Research Center](); [CNN.com]()

Projected U.S. population by generation*



* Excludes the silent generation and post-millennial generation
** Range of birth years may be updated as further demography studies about this generation are conducted

And this group of prospective customers expects "retailization" of P&C insurance coverage. Most of these consumers expect an omni-channel information gathering and purchasing experience, wherein online and mobile are vital, and showcasing easy-to-digest and understandable information is essential. If a given insurer is not meeting expectations for personalization, customization, easy access, and product/price transparency, customers can, and will, move on to another provider.

Charting the Course through Stormy Waters

Everest Group has identified three key digital solutions that will enable traditional insurers to weather the uncertainties of this perfect storm of disruptive forces and drive sustainable growth by innovating and decreasing their cost to serve customers:

1. Analytics: leverage claims and fraud analytics in claims processing, and advanced algorithm-based actuarial modeling in product development

2. Automation: adopt RPA technology in claims processing and policy servicing

3. Advanced IT: deploy mobile applications and implement SaaS solutions running on a cloud infrastructure for non-core operations

Analytics

Although P&C insurers have been early adopters of analytics, most solutions they are currently using are relatively unsophisticated, focusing primarily on generating reporting and insights from past and current situations. The lack of advanced analytics solutions is prohibiting P&C insurers from predicting and prescribing actions focused on accurately underwriting risks, improving claims processing, and preventing fraud.

Near-term adoption of claims and fraud analytics in claims processing and advanced algorithm-based actuarial modeling in product development will enable P&C insurers to facilitate more consistent claim resolution, prevent fraud, accurately price risks and reduce operating costs.

Here are Everest Group's specific analytics recommendations and key success factors:

- **Invest in claims analytics to increase reliability and improve cycle times.** Investment in analytics in key claims areas such as scoring, subrogation, and litigation propensity models, will help insurers to analyze claims data, leverage similar historical cases, and standardize claims settlements using a consistent decision-making process. This will not only improve the trustworthiness of the settlement data for insurers and their customers, but also increase customer satisfaction and retention.
- **Invest in fraud analytics to proactively combat fraud activity, drive innovation, and exceed customer expectations.** Insurance-related fraud in the United States is approximately $40 billion per year and costs the average family between $400 and $700 per year in the form of increased premiums[9]. Current fraud detection processes are mainly manual, lack reliability,

9 Federal Bureau of Investigation, Insurance Fraud, https://www.fbi.gov/stats-services/publications/insurance-fraud

and have long lead times. Everest Group research in 2017 found that the application of fraud analytics will reduce fraud-related cost by 10- 20 percent, enabling a $3-$6 billion savings opportunity. Investments in claims origination, FNOL, and customer behavior analytics will give insurers the ability to identify common fraud schemes and analyze customer behavior patterns. Investing in advanced algorithm-based actuarial modeling and underwriting analytics will help them accurately price properties/products that are prone to future catastrophic losses. This, in turn, will help insurers drive innovation, reliability, and transparent pricing mechanisms that align to customer expectations.

- **Focus on acquiring capabilities that improve risk accuracy.** Insurers need to concentrate on building capabilities that enable access to big data from a variety of sources (e.g., historical claims, real-time weather, and social networks) and apply advanced algorithm-based actuarial modeling. The current lack of sophistication in actuarial and underwriting analytics precludes a forward-looking view on risk, preventing accurate modeling of the extent of losses for future catastrophes against which to accurately price property products and determine the need for reinsurance. Analytics will help insurers pinpoint where risks reside, and develop mitigation strategies that specifically address the identified risks.
- **Ensure availability of reliable data to operationalize advanced analytics**. Lack of reliable data and the creation of organizational data silos due to a fragmented/legacy system landscape will hinder implementation and operationalization. The lack of integration between internal and external data sources may also affect the number of factors used to price risk. Investing in understanding what and where data is available in the organization and in cleaning up the quality of the data will help insurers increase the credibility of the data and remove barriers to effective operationalization.
- **Revisit the talent model to address the shortage of advanced skills.** Only the P&C insurers that successfully acquire, train, and retain data scientists/miners, actuaries, statisticians, etc., will be able to successfully leverage advanced analytics.
- **Look for opportunities to partner/acquire InsurTech firms to get ahead of the competition.** Traditional P&C insurance firms can partner with or acquire InsurTech firms to gain access to their advanced analytics capabilities within their diverse customer base and product offerings.

Automation

Everest Group research shows that ~40 percent of U.S. P&C insurers have begun adopting RPA, focusing on highly transactional processes such as claims management and policy servicing. Within these insurers, automation has been implemented at the task- or activity-within-a-process level, applying automation only where there are problems and bottlenecks. Just under a third of insurers are already ahead of their competitors, scaling up existing RPA operations and also considering and/or running pilots on cognitive automation[10].

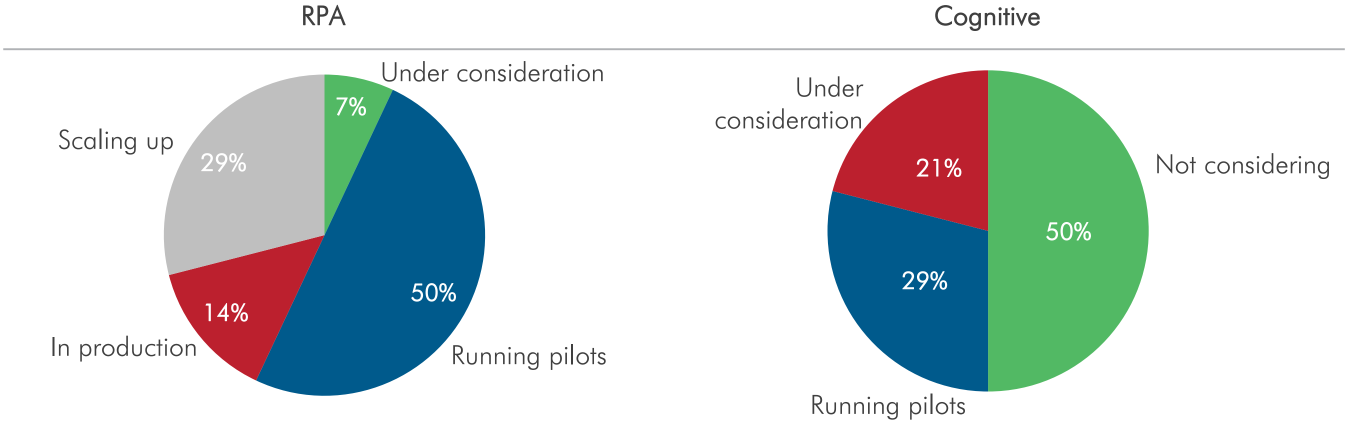
10 Sarah Burnett, Anupam Jain, Amardeep Modi, Everest Group, *Rise of Automation in P&C Insurance* (2017)

EXHIBIT 3

Percentage of respondents

Source: Everest Group

State of adoption of RPA and cognitive automation within the P&C insurers surveyed



Automation is projected to reduce costs associated with operations by 20 to 25 percent[11]. With operations at $35 billion in 2015[12, 13, 14], automation will create an approximately $7-9 billion savings opportunity for the P&C insurance industry. But cost savings is just one of the many benefits automation delivers.

Everest Group's automation-related recommendations and key success factors include:

- **Invest in automation as the tool to improve process efficacy and help deliver the overall digital solution.** Automation alone is not a magic bullet. Optimizing IT and business processes, then applying automation, will yield much better results and free up more capacity than applying automation to legacy systems. Doing so will significantly reduce rework and cycle times, increase straight-through processing, improve governance and compliance, decrease internal security risks from data theft, and enhance business continuity. Insurers can leverage automation for both IT and business processes to provide minimal near-term gains while developing the future strategy. Insurers' long-term goal should be adopting RPA in an end-to-end process to allow more efficiency gains.
- **Leverage automation solutions to mitigate risks associated with job protectionism mandates.** Claims processing and policy servicing account for 83 percent of offshore resources in the insurance industry[15]. If the Trump administration implements policies that force insurers to reshore these processes, automation (e.g., RPA) offers a solution to offset the economic and operational impact through a virtual workforce. For those in the process of implementing RPA, the focus should be an end-to-end approach to automation to unlock scalability potential and shift from manual control and management of the processes.

11 Everest Group, *IT Outsourcing in Insurance – Annual report 2016: Disrupt or be Disrupted* (December 2016)
12 McKinsey, European Insurance and Asset Management (April 2015)
13 Federal Insurance Office, *Annual Report on the Insurance Industry* (September 2016)
14 Everest Group (2017)
15 Everest Group (2017)

- **Build a longer-term vision that includes flexibility to move to cognitive automation.** Given the high complexity of cognitive automation – which applies artificial intelligence, machine learning, and Natural Language Processing (NLP) – P&C insurers need first to succeed on the deployment of RPA and gain stakeholder buy-in. Surveys indicate that ~85 percent of IT executives are not aware or have only a medium level of understanding of cognitive automation[16]. Focus on ways to increase awareness and demonstrate the value of automation.
- **Spend the time upfront to standardize current processes and implement lower complexity, high transactional processes.** Lack of process standardization and optimization in the value chain is often the main constraint in the successful implementation of automation capabilities. Partial automation is difficult to scale and focuses primarily on worker productivity. To successfully lead the automation journey, take the time up front to standardize processes and move less complex work to get the immediate return, with the strategy to evolve to higher level / more judgmental processes.
- **Start looking at opportunities to optimize the workforce.** The rise of automation will have a significant effect on the workforce pyramid. The current delivery pyramid is bottom-heavy, with the majority of FTEs manually handling highly transactional processes. However, over the next 10 years, it is expected that approximately 25 percent of full-time positions in the insurance industry may be consolidated or replaced, with the biggest impact on operations and support functions. P&C insurers must upskill their workforce with a high percentage of mid- and senior-level positions. Additionally, they will need to reorganize the roles and responsibilities and harmonize technology with human-related capabilities.

Advanced (or modernized, digital) IT

Legacy IT systems for insurance companies were designed for product-specific functionality. Over time, issues have emerged around lack of scalability, flexibility, and integration complexity, leading to higher maintenance costs and lower customer service quality. Moreover, finding talent with specialist operating knowledge of the legacy systems is becoming increasingly difficult.

Legacy systems are also inhibiting value capture from digital solutions. Insurers that fail to invest in IT modernization will be at a distinct competitive disadvantage and risk declining business performance, failing customer expectation, loss of market share, and increasing operating costs.

Next-generation P&C customers have a higher propensity to choose insurance providers based on product offerings and solutions that enhance the user experience.

To satisfy customers' desires and stay ahead of the competition, insurers must invest in short-term digital technology solutions aligned to the bigger IT visions, rather than wait for completion of advanced transformation. Digital adoption allows them to leverage technologies to drive efficiencies across operations and support functions. To leverage real-time data into useful customer insights, P&C insurers must embed tools, such as advanced analytics, cognitive automation technologies, and big data solutions, into their business processes. They need to adopt solutions that both work to improve cost in the near-term and build the foundation for the future.

16 Sarah Burnett, Anupam Jain, Amardeep Modi, Everest Group, *Rise of Automation in P&C Insurance* (2017)

Following are Everest Group's recommendations and key success factors for leveraging advanced IT:

- **Identify opportunities to simplify the legacy technology environment to improve, attract/retain customers, and mitigate risk.** Investing in advanced technology-led enhancements directly impacts the customer experience, drives premium growth through competitive pricing, maximizes cross-selling capabilities, leads to reduced new business cycle time and withdrawals, and reduces overall maintenance costs by up to 15 percent[17]. Advanced IT capabilities help mitigate regulatory, underwriting policies, and standards compliance risk, and provides greater business continuity and disaster recovery capabilities. P&C insurers can capture immediate operations efficiency and reduced application maintenance cost benefits by completing an application rationalization exercise including: retirement of less frequently used and low business impact applications; replacement of outdated critical applications that are slow and cumbersome; and consolidation of redundant platforms, processes, and applications that have resulted from industry M&A/consolidation activity. The focus on cost reduction in mid- and back-office operations for near-term cost reduction minimizes risk and service disruption versus a "rip and replace" of the core IT, customer-facing, and compliance-related layers.
- **Focus now on delivering improvements in insurance services via mobile applications to meet customer expectations.** Insurers with a weak mobile presence need to act quickly and provide basic insurance services via a mobile application, with features such as real-time customer service, roadside assistance, and claims reporting. New features such as account management, price comparisons, messaging, home inventory management, and claims history can then be add-on enhancements. This strategy will help build customer trust without the high up-front investment.
- **Bridge legacy core IT systems with a new layer of technology.** The volume of data insurers need to gather, manage, and analyze is growing at an exponential pace, as cars, home security systems, fire alarms, and commercial equipment join the connected world[18]. Short-term investments and leverage of cloud infrastructure, application stack, and the IoT will enable insurers to integrate siloed business units, access historical data freely to create flexible models and gain customer-centric insights, build more accurate risk models, and reduce costs. P&C insurers can use the customized data to create new personalized products and services for a pay-per-use model and to drive top line growth.
- **Invest in as-a-service subscription-based solutions that will provide immediate benefit as flexibility for future decisions.** Everest Group research found that SaaS tools applied with process automation can help reduce P&C insurers' support function costs by 10-15 percent. The as-a-service model is consumption-based and on-demand, thereby improving value capture, reducing operational costs, and accelerating adoption of new technologies and capabilities. The as-a-service model will also enable insurers to store large quantities of data, scaling the storage if/as needed. Additionally, the model allows flexible, agile, and fast reaction to changes in business needs. Finally, P&C insurers can delay high initial investments on IT transformation projects, and redirect part of their capital expenditure as an operational expense for as-a-service.

17 Protiviti, Modernizing Legacy Systems in Insurance; The Case for Transforming Core IT Systems in the Insurance Industry (2016),3. https://www.protiviti.com/US-en/insights/modernizing-legacy-systems-insurance

Conclusion

There is no magic bullet that will allow P&C insurers to resolve all the issues that are plaguing them or bypass the storm of uncertainties that loom. Rather, focused actions, decisions, and strategic investments in several key digital areas will set them on the ideal path forward. These include analytics solutions, such as: advanced algorithm-based actuarial modeling to improve claims processing and fraud detection; deeper adoption of RPA in claims and policy servicing; and, implementation of new, advanced technologies to bridge immediate legacy system issues.

Decisive near-term actions aligned to a longer-term vision that allows for flexibility will allow P&C insurers to drive growth and address traditional profitability and competitive challenges, as well as manage through current uncertainties and risks.

About Everest Group

Everest Group is a consulting and research firm focused on strategic IT, business services, and sourcing. We are trusted advisors to senior executives of leading enterprises, providers, and investors. Our firm helps clients improve operational and financial performance through a hands-on process that supports them in making well-informed decisions that deliver high-impact results and achieve sustained value. Our insight and guidance empower clients to improve organizational efficiency, effectiveness, agility, and responsiveness. What sets Everest Group apart is the integration of deep sourcing knowledge, problem-solving skills and original research. Details and in-depth content are available at www.everestgrp.com.

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