On the precipice?
Navigating a paradigm shift in the insurance industry

The insurance industry is in the midst of simultaneous changes unlike any that it has experienced in its history. Fundamental, paradigm-shifting forces are coming from all directions; exciting new innovations and business models are being driven by a number of disruptors. For individual insurers, ongoing prosperity—even survival—demands they embrace new innovations and technologies to meet ever-changing customer demands, and improve core operations and functions.

At Grant Thornton LLP, we see insurance entering a dynamic period. We believe these changes will redefine insurance as we know it, with the potential to upend the industry.

Fundamental shifts driven by evolving customer demands

Remember when cameras used something called film, and digital photography was a novelty? Compare that to the precipice our industry sits on today:

- Brand new startup entrants shaking up the market: Insure-tech, peer-to-peer insurance companies, and fully digital companies threaten existing business models and longtime players
- The heavy hitters of the tech sector are getting into the game. With Google already investing in insurance ventures, can Amazon and Facebook be far behind?

All the while, notes Chris Smith, Grant Thornton National Strategy Practice Leader, the expectations of consumers are changing. “No longer do they compare their insurance company experience to other insurance companies; instead, they compare it to Amazon, Netflix, Uber and other new companies,” Smith observed.

And the younger generation of buyers—Generation Y and millennials—are shunning insurance. “Customers of the future feel less of a perceived benefit and find insurance a hassle to purchase,” Smith added.

"Across the board, an increasing number of consumers prefer a seamless shopping experience that starts online and fulfills online or, if desired, through such channels as phone or mail."

So what does smart look like for today's insurance leaders? We are focused on three areas:

- Creating deeper insights and understanding throughout their organizations
- Leveraging the most advanced tools to meeting consumers where they are and striving for maximum efficiency
- Keeping in close touch with nascent regulatory shifts that quickly could become major challenges

Deeper insights drive smarter decisions

Insurance companies are voracious producers of data. Yet compared to other sectors in financial services, insurers are behind the curve when it comes to mining that raw data for game-changing insights.

Matt Tierney, a Grant Thornton Regional Insurance Practice Leader, observes that data analytics offers insurance carriers tools for opening windows into the data they already possess. Tierney has helped Grant Thornton clients achieve benefits in their front-, middle-, and back-office operations: "Most insurers have adopted pockets of data analytics here and there. But few are realizing its full potential."

According to Tierney, the most immediate benefits of data analytics reside in the front office. Historically, insurers have followed an antiquated model for sustaining customer relationships, with little interaction between the initial sale and (unless there's a claim) the renewal a year later. "Insurance companies rarely understood or segmented their customers based on customer profitability or loan-to-value," Tierney noted. "Many are just beginning to appreciate how much smarter and more profitable it is to retain a customer versus the cost of acquiring a new one."

Traditional insurers also overlook new opportunities to leverage innovative customer information. Examples include online purchase patterns, online profiles and social media interaction, and fitness tracking to support life insurance underwriting decisions. "Leaders in the industry are leveraging data associated with customer acquisition and retention to gain market share," Tierney observed.

In the middle office, data analytics offers the promise of smarter underwriting decisions and the ability to layer new data sets into the decision matrix, such as geography, occupation, travel frequency, driving history and more. Likewise, econometrics—combining data science with actuarial science and statistical analysis—supports more accurate underwriting and risk decisions. With these additional data points,

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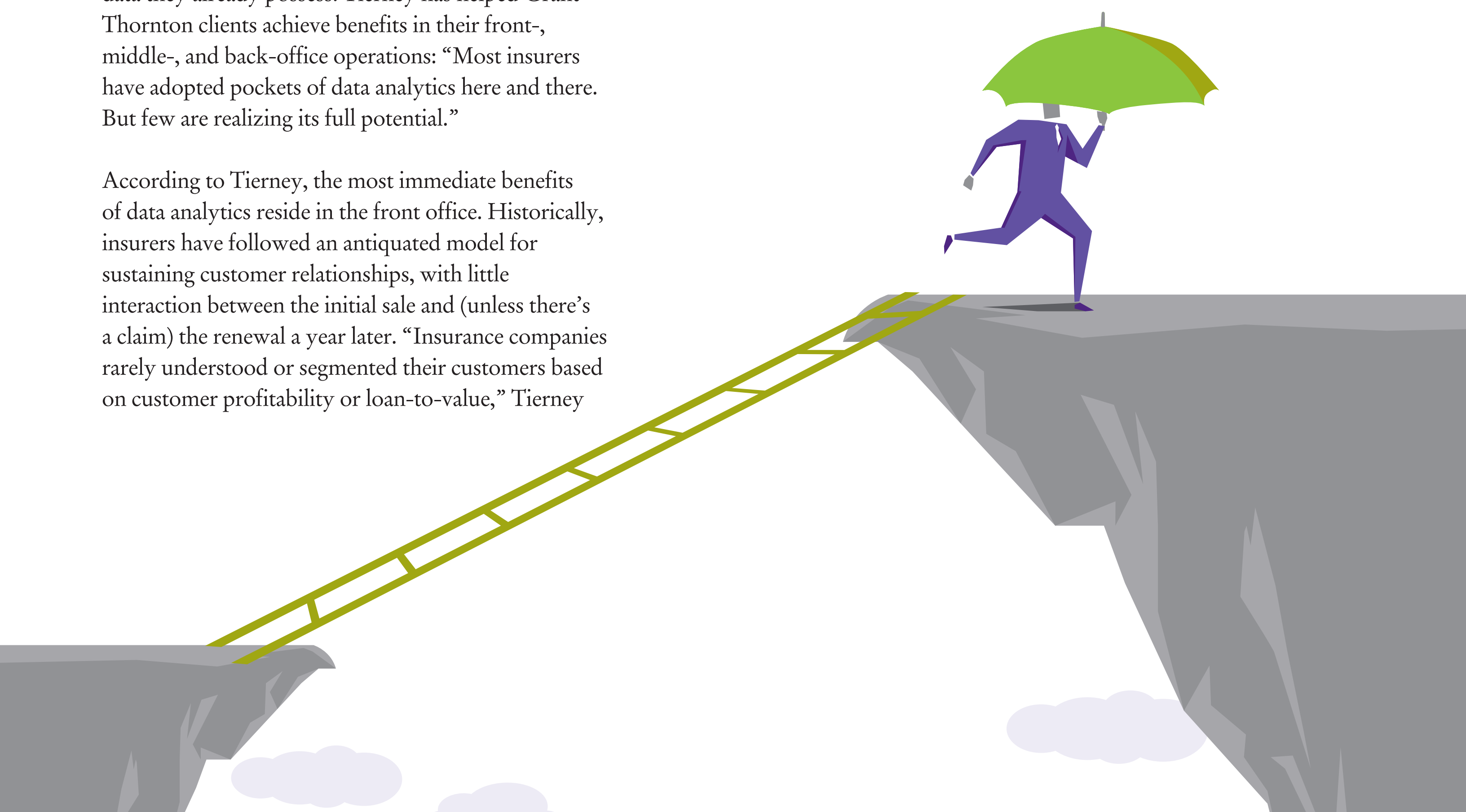


insurers can make better selections of whom to accept, set more equitable premiums and offer appealing rates to the most attractive customers.

In the back office, data analytics can solve a multitude of problems, such as spotting fraud, accelerating financial planning and analysis, and aiding monthly closes. In the best applications, data analytics empowers leadership with real-time data in contrast to a 30- to 40-day look back at the state of the business.

Ultimately, Tierney sees data analytics as a tool that's a cost-effective solution and comparatively simple to adopt. "All of the popular analytics tools sit on top of existing data warehouses," he explained. "They are relatively easy and affordable to put into place and have the potential to deliver immediate payback throughout the organization."

Driving ROE with artificial intelligence and robotic process automation

Technologies advancing in step with data analytics for insurance carriers are artificial intelligence (automation) and robotic process automation (robotics). According to John Swanick, National Insurance Sector Leader, these technologies turn the insights provided by data analytics into much-needed efficiencies.

"Insurance is at the perfect place to adopt automation and robotics," Swanick explained. "Thanks to an overabundance of capital, low interest rates and soft markets, most insurers are not generating the return on equity [ROE] they should be. These new technologies offer the opportunity to drive efficiency and improve ROE."

In Grant Thornton's experience, the investment required to adopt automated solutions is typically about 10 percent of the one-year salary cost of the function they're assuming. "Automation and robotics is cost-effective to adopt and allows insurance firms to retrain and redeploy their people on higher-value activities that can further drive growth," Swanick noted.

Vivek Rodrigues, a Senior Manager specializing in strategy and performance improvement, also points out that robotics is becoming more attractive as offshoring of administrative functions becomes more expensive. "Wage rates are rising in the popular outsourcing destinations," he noted. "Even in India, offshoring isn't nearly the attraction it was a few years ago."

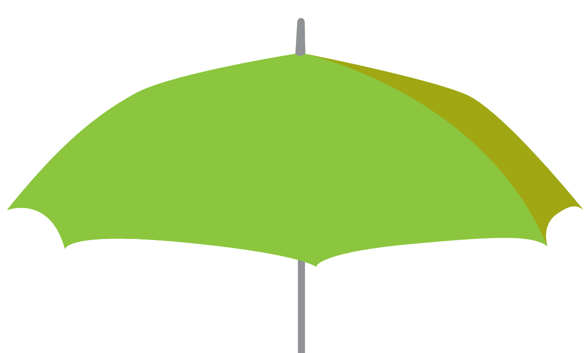
Unlike data analytics, which has been taking hold for several years, automation and robotics are just coming into their own. "A year ago, it was a novel concept," Swanick observed. "A year later, we're seeing insurers who are anxious to adopt."

As the tools have become more sophisticated, insurers are leveraging them not only to replace manual work but also to make a wide range of business decisions. According to Swanick, they're stepping into many of the insurance industry's most labor-intensive tasks, including:

- Accounts receivables
- Cash receipt processing
- Claims processing
- Bordereau processing
- Bank reconciliations
- Cash reconciliations
- Premium reconciliations

"For insurers, the biggest challenge in adopting automation and robotics isn't the tools themselves—those are getting more sophisticated all the time," Swanick said. "The real work is in examining and retooling business processes so they're ready to make the leap."

"Insurance is at the perfect place to adopt automation and robotics"



Preparing for new forms of regulatory pressure

The insurance industry has always been governed by a complex web of federal and state regulations, making compliance an ongoing challenge. Yet in the context of the many fundamental shifts that are simultaneously bombarding the industry, anticipating and preparing for new mandates well in advance takes on additional importance.

With that in mind, Grant Thornton is paying close attention to the new cybersecurity regulation pending in the state of New York. When it comes to regulating the financial services sector, other jurisdictions look to New York for best practices, much like they look to California for leadership on ecology issues. So when New York tightens the screws, it's reasonable, even likely, to expect that copycat regulations will pop up around the country.

In the news release confirming the effective date for its new cybersecurity regulation, New York Gov. Andrew Cuomo said, "These strong, first-in-the-nation protections will help ensure this industry has the necessary safeguards in place." His quote gets it right: Nowhere else in the nation, or the world for that matter, are regulations this stringent regarding cybersecurity.

According to Mark Lastner, Grant Thornton's National Insurance Advisory Leader, the new regulation aims to achieve three goals:

- Establish regulatory minimum standards for cybersecurity
- Promote the protection of customer information as well as IT systems of regulated entities
- Require each company to assess its specific risk profile and design a program to address its risks

While those three goals seem reasonably achievable, the depth of the requirements are an order of magnitude greater than past regulations. He cites such examples as:

- Material events must be reported to regulators within 72 hours—a virtual blink of an eye in terms of understanding and assessing a cyberevent
- Encryption is required for all nonpublic information in transit and at rest, stretching up to five years
- Customer access must be made far more secure through such techniques as mandatory two-factor authentication, privileged access to databases and support for multifactor web access

Another departure from past regulations is how broadly they apply. Unless an insurer can demonstrate it meets these criteria—fewer than 1,000 clients in New York for each of the past three years, less than $5 million in gross annual revenue over the same period and less than $10 million in total year-end assets—the compliance criteria are identical.

Lastner noted that insurers active in New York need to jump on compliance without delay. "Even though insurers aren't required to demonstrate compliance until early 2018, the new regulations actually became effective on March 1, 2017," he said. "Should they suffer a breach, they need to be in full compliance with reporting requirements."

The road ahead

At Grant Thornton, we believe the insurance industry is on the edge of realignment. While insurance itself will continue to provide important protection and peace of mind to consumers and businesses alike, the industry makeup itself will shift significantly.

Nevertheless, we expect extraordinary success in the coming few years for insurers who are smart, innovative and adaptive. In this period of fundamental change, however, their success may come at the expense of those who lack the agility to keep pace.

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