LESS IS MORE: LEAN 2.0 PROGRAMS IN THE GLOBAL INSURANCE INDUSTRY

EU INSURERS MUST ADAPT AS NEW SALES REGULATIONS LOOM

THE FUNDAMENTAL TRENDS RESHAPING LIFE INSURANCE

THE COMMERCIAL-INSURANCE AND REINSURANCE MARKETS: LONDON VERSUS THE WORLD

INSURANCE ASSET MANAGERS ATTACK THE TARGET-OPERATING-MODEL OPPORTUNITY

BRINGING BIG DATA TO LIFE: FOUR OPPORTUNITIES FOR INSURERS

A ROADMAP FOR WINNING AS INSURANCE GOES DIGITAL
The Boston Consulting Group (BCG) is a global management consulting firm and the world’s leading advisor on business strategy. We partner with clients from the private, public, and not-for-profit sectors in all regions to identify their highest-value opportunities, address their most critical challenges, and transform their enterprises. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 1963, BCG is a private company with 81 offices in 45 countries. For more information, please visit bcg.com.
The insurance industry is evolving and being challenged to rethink the ways it does business. The industry is being confronted by exploding growth in mobility and network technology; a more restrictive regulatory environment that affects risk management, privacy, and distribution; shifting customer behaviors and demands; and intense pressure to run leaner, more efficient organizations. All these factors are contributing to the creation of a landscape of opportunity.

To reflect this reality, we present a collection of perspectives on the dynamic world of today’s global insurance industry. Our mission is to highlight the number of ways we believe insurers can create value and achieve competitive advantage. Here are descriptions of just a few of the pieces you will find inside.

Two articles in this publication focus on the digital insurer. One of them addresses the ways that traditional insurers are being threatened by digitally native competitors and provides insights into how to stay ahead. The other takes a look at big data in the life insurance industry, noting that forward-thinking life insurers are applying four growth strategies to discover new opportunities for efficiency and innovation.

Also inside, a piece focused on the shifting regulatory landscape driven by three initiatives—the Insurance Mediation Directive, Packaged Retail and Insurance-Based Insurance Products, and the Markets in Financial Instruments Directive—offers guidance to insurers for building a regulatory strategy. The material in this article was originally published as part of a report that was prepared in collaboration with Sanford C. Bernstein, a financial-research company.

To round out this publication, we have included an “infographic” on the shifting landscape of the global commercial-insurance market. The infographic is based on an extensive analysis we conducted with London Market Group.

I hope you will enjoy these articles. As always, the authors and I would be happy to discuss our perspectives with you. Feel free to provide feedback by sending e-mail to insurance@bcg.com.

Heiner Leisten
Global Leader, Insurance Practice
In many industries, the changes brought about by digital technology are already evident. Industries as diverse as entertainment, travel, and retail have been disrupted by the emergence of new players using technology to create products and services that offer something new or better. These digital-only players have staked out a valuable position with consumers—and traditional companies are feeling the impact. Just ask the TV companies competing with Netflix, the travel companies competing with Travelocity and Expedia, and the retailers competing with Amazon.

The insurance industry has taken longer to join the rush to a universe of bits. The sales model of agents helping consumers figure out which products to buy has largely remained intact in Western countries, and most insurers haven’t yet felt a big impact from digitization on their revenues.

That is changing as more and more consumers begin to handle their insurance transactions online. A new ecosystem is taking shape, and it will affect every part of the insurance-industry value chain. Companies that don’t adapt will become increasingly vulnerable.

The good news is that digitization doesn’t necessarily mean that traditional insurers will be “Amazoned.” In every area of insurance, all over the world, traditional insurers can use the Internet, mobile technology, and social media—as well as some reworked legacy technologies—to fend off new rivals and get ahead of long-time competitors. The challenge lies in coming up with a roadmap for digitization: where to start, what to change, how much to invest, and how to make it all happen.

Consumer Attitudes

Consumer attitudes toward insurance are changing. In its most recent survey of consumer sentiment, The Boston Consulting Group (BCG) found that approximately 15 percent of consumers in Western nations would, if possible, conduct all of their transactions with insurance providers remotely. That was up from roughly 5 percent two years earlier. Another 50 percent or so would prefer their dealings with insurers to be a hybrid of online transactions and interactions with sales or service people, up from 30 percent two years earlier. In our opinion, the percentage of remote-only users would be higher if the interfaces for common transactions—such as buying a policy, submitting a claim, and modifying an existing policy—were easier to use and more intuitive. But the shift in attitude, which is happening across all socioeconomic groups and applies to every type of insurance, should be enough to get the industry’s attention all by itself.

The trend of consumers handling more of their insurance needs on their own is already
evident in the early stages of the insurance-buying process. The vast majority of consumers do the bulk of their initial research online, using tools such as search engines and comparison engines, over which insurers have little control. Most of these customers do still turn to agents to finalize their purchases, and that may lead some insurers to think that their traditional networks retain their old relevance. But in many cases, the only real utility provided by insurance agents lies in clarifying and confirming the many policy details that are confusing online. Indeed, in the eyes of consumers, insurers’ websites are among the worst of any major industry. Recent research by BCG in the U.S. highlights the dissatisfaction that consumers feel when they interact digitally with their insurers. (See Exhibit 1.) But this dissatisfaction is not limited to the U.S.; consumers in most other parts of the world feel it, too. (See Evolution and Revolution: How Insurers Stay Relevant in a Digital Future, BCG report, September 2014).

Digitization Is Critical in Three Parts of the Value Chain
Most insurance companies understand that digitization is starting to have an effect on the way they do business. But very few of them have devised a roadmap for how to change. Perhaps the best place to start is with the three parts of the value chain on which digitization is likely to have the biggest impact: internal operations, go-to-market strategies, and risk.

Internal Operations. Insurers have made the most headway here. The benefits stem partly from straight-through processing, which reduces insurers’ use of paper processes and lowers their transaction costs. Digitization of operations also involves developing interfaces for providers such as physicians and hospitals—again, with the goal of streamlining processes and reducing costs.

In many cases, the new guard of digital-only competitors already has paperless processes and highly efficient approaches to handling transactions, which has allowed them to build a significant advantage in terms of variable costs. The per-policy processing costs of one digital-only automobile insurer who shared this information with us, for example, are 30 percent lower than those of traditional insurers, with which the digital-only insurer is starting to compete. If traditional insurers are

EXHIBIT 1 | Consumers Think That the Digital Experiences Offered by Insurance Are Among the Worst

How U.S. consumers rate different industries for the online experience they provide

<table>
<thead>
<tr>
<th>Industry</th>
<th>Digital Satisfaction Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal banking</td>
<td>15.2</td>
</tr>
<tr>
<td>Online merchants</td>
<td>11.8</td>
</tr>
<tr>
<td>Media retail</td>
<td>11.1</td>
</tr>
<tr>
<td>Apparel retail</td>
<td>10.0</td>
</tr>
<tr>
<td>Electronics retail</td>
<td>8.9</td>
</tr>
<tr>
<td>Airlines</td>
<td>8.5</td>
</tr>
<tr>
<td>Investments</td>
<td>8.5</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>8.0</td>
</tr>
<tr>
<td>Hotels</td>
<td>5.8</td>
</tr>
<tr>
<td>Electricity, gas, water</td>
<td>5.0</td>
</tr>
<tr>
<td>Government services</td>
<td>4.3</td>
</tr>
<tr>
<td>Health care providers</td>
<td>4.2</td>
</tr>
<tr>
<td>Insurance</td>
<td>4.1</td>
</tr>
<tr>
<td>Real estate</td>
<td>3.8</td>
</tr>
<tr>
<td>Telco and cable</td>
<td>3.5</td>
</tr>
</tbody>
</table>


Based on maximum difference scaling: consumers distributed 100 utility points across segments to reflect their perceived digital satisfaction; segment scores do not add up to 100 because of data weighting.
to remain competitive, they must move faster to make their legacy systems more flexible and better able to operate in real time. This is a significant implementation challenge that will require a lot of planning and investment.

Another way to increase efficiency is by introducing self-service portals. Such portals could allow policyholders to do certain transactions online, without any paperwork or assistance. Insurers face a challenge with the self-service approach, however—which is how to go beyond the mere digitization of existing processes and offer an experience that truly takes advantage of the medium. If insurers believe that providing self-service means simply allowing their customers to access forms online and send those PDFs back via an electronic process, they will be missing both the point and the larger opportunity.

The biggest go-to-market opportunity for insurers involves development of direct sales.

Even insurers that have a clear sense of what they should be offering in the way of self-service need to figure out how to make such investments pay off. In the current structure of the industry, independent agents develop customer relationships and, in many cases, handle customer service as well. More self-service options could reduce the burden on these independent agents without necessarily increasing customers’ loyalty to the insurers themselves. This is an unintended consequence that insurers should take pains to avoid.

Go-to-Market Strategies. By far the biggest go-to-market opportunity for insurers involves the development of direct sales, which usually take place online and are not brokered by an intermediary. These sales have been slow to materialize in the industry because of resistance from traditional sales channels and because of the inherent complexity of insurance products. Perhaps not surprisingly, insurers that have seen early success with direct sales haven’t had any channel conflicts to worry about; they sell insurance online or through telephone fulfillment staffs and don’t rely on agents to generate business. One example is CosmosDirekt, a German insurer that surmounted the complexity issue by putting the application and approval process for term life insurance entirely online. The company has since built on its success in term insurance and is now offering other kinds of insurance.

CosmosDirekt is not alone; other innovative insurers have also gotten over the complexity hurdle and are using a simplified interface to sell directly to consumers. Another good example is Oscar, a start-up health insurer serving residents of New York State in the U.S. With its intuitive graphics and easy-to-use search tools, the company’s online service is bridging the gap that has traditionally separated consumers from insurers.

Direct sales are destined to take significant share from traditional insurance channels, making investments in this area not just an add-on source of revenue but a competitive necessity. However, direct sales are only going to work for insurers that rethink how they build, develop, and market their products. The experience needs to feel new, not like the same old interaction transferred to a new medium.

The second big go-to-market opportunity for insurers lies in giving their full-time salespeople digital-sales tools. Such tools include customer-relationship-management systems that help with some aspects of lead generation and customer service, and that make it easier for sales agents to up-sell and cross-sell. The tools also include portable devices. For instance, the German insurer Allianz started a pilot project in Italy in which agents bring iPads on their visits to clients’ homes and places of work. The agents are able to display benefit information and generate price quotes on the spot, eliminating the inconvenience of follow-up meetings and increasing the likelihood that customers will make impulse buys. When programs involving portable devices are properly implemented, insurers can realize significant productivity gains, with agents managing as much as 25 percent more business than they did previously.
Another very important thing for insurers to learn is how to gain more visibility when consumers are researching which insurance products to buy. Affinity marketing—the tactic of teaming up with a well-known brand in order to bring an offer to a prospect’s attention—can play a big role here. In the U.S., for instance, New York Life Insurance has a deal to sell life insurance and annuities to members of the AARP, an organization with a membership of 37 million retirees. In China, the online insurance company Zhong An has started out with some can’t-miss affinity partners, including the shopping site Alibaba, for which Zhong An will insure property and cargo; the Internet gaming company Tencent; and Ping An Insurance, one of China’s largest insurers. Most of the new digital insurers that have captured significant premiums have done so with the help of an affinity partner. Affinity marketing helps insurers show up on consumers’ radars at an earlier stage of the research process.

Risk. This is the dimension in which digitization has the greatest financial potential, and some insurers have already begun pilots in this area. But the business models involving risk reduction are embryonic, and there is no clear roadmap for moving forward. Very few insurers have had significant success in this area.

Underwriting is one area of risk in which insurers could capitalize on digitization. The science of using actuarial tables and other statistics to create and price insurance products has been around for well over a century and is quite mature. But information from social media, GPS systems, and big data could lead to improvements in insurers’ ability to assess risk.

For instance, auto insurers are starting to use data gathered by telematics devices and mobile-phone applications to determine premiums for new clients—a segment-of-one approach that could make it possible for demonstrably safe drivers to pay lower premiums. That data could also help the auto insurer adjust the prices of policies in subsequent years and more accurately assess the risk of each policyholder. (See “Big Data to Life: Four Opportunities for Insurers,” page 29.)

Big-data analytics could help insurers more accurately assess other kinds of risk as well. For instance, a mortgage life company might be able to use data from social networks to estimate its loss reserves more accurately by spotting lifestyle changes and recognizing how they might increase an insured person’s risk. And in claims management, companies with more sophisticated approaches to data are already doing a better job of identifying outlier claims, thus reducing their exposure in an area that has historically accounted for a disproportionate percentage of payouts. For example, if an insurer is able to recognize that the injuries suffered by someone in a car accident are atypical, it could arrange for more effective early treatment—thereby lowering the total reimbursements it must make to hospitals and physicians.

The intersection of devices and loss prevention presents a wide-open opportunity.

The intersection of devices and loss prevention—the vaunted Internet of Things—presents another wide-open area of opportunity. It’s easy to imagine how payouts could be reduced if property and casualty insurers used sensor-driven devices to detect and respond to events such as water leaks, break-ins, and fires, for instance, or if health insurers equipped cardiac patients with heart-monitoring devices that immediately forwarded abnormal readings to the patients’ physicians. What’s harder to imagine is the business model: figuring out who to partner with, how to pay for the devices, and how to set up exclusive deals with device makers.

Early pilots are under way in all of these areas. The British insurer Aviva is using unstructured data, including online spending habits and public Facebook postings, to get a sense of its customers’ lifestyles, do predictive modeling, and set premiums for life insurance policies. Some companies—including
Aviva and two U.S. insurers, Progressive Casualty Insurance and Allstate Insurance—are also experimenting with using data from mobile apps and in-car telematic devices to price automobile insurance. It’s too early to know how these initiatives will fare, but we think that, in the aggregate, risk initiatives have considerable promise. (See Exhibit 2.)

Unfortunately, risk is also one of the areas in which traditional insurers face the biggest threat of disruption. One need only consider the strategy followed by Rakuten, Japan’s largest online retailer, to understand the frontal assault that Internet companies can make on insurers. A couple of years ago, Rakuten bought AIRIO Life Insurance; Rakuten is now in a position to use the vast amount of data it has on Japanese spending habits—seven out of ten Japanese are repeat Rakuten customers—to price the life insurance policies that it sells to consumers.

Or consider what might happen if Google, whose footprint is considerably larger than Rakuten’s, decided to get into insurance. Given what Google knows about consumers, it’s not hard to imagine the company being able to offer a more innovative approach to risk assessment—and therefore to insurance pricing—than the one offered by traditional insurers. Regardless of how or where the Internet data giants might enter the insurance ecosystem, it is clear that they could alter it profoundly and irreversibly.

There’s also the possibility of competition from companies that haven’t traditionally been direct sellers of insurance, such as automobile original-equipment manufacturers, airlines, and telecommunications companies. In short, the threat to insurers’ business models could come from just about anywhere.

### Developing a Roadmap for Digitization

For insurance companies, digitization is a complex equation with three variables: consumers’ evolving preferences, changes in insurers’ internal operations and technology, and emerging ways to assess, analyze, and manage risk. These changes create the possibility of a very different future. Direct players could become business process outsourcers, offering their platforms for others to use as delivery mechanisms for low-cost insurance products. Internet specialists and affinity marketers could alter traditional insurance-
distribution channels. Data giants could become the engines behind risk assessment. Equipment makers and utilities could make off with part of the claims business. No part of the value chain is safe.

For insurers, the key is to re-imagine the whole consumer experience.

To best position themselves for success, insurers must develop a roadmap that takes into account four factors:

- **The Altered Ecosystem and New Partnership Possibilities.** As new players emerge—in some cases with unique value propositions—traditional insurers will have to decide how to position themselves. This starts with an analysis of how their part of the insurance ecosystem will develop. In some areas, traditional insurers may remain at the center of the ecosystem and have an opportunity to federate within it. But this won’t be a natural role for many insurers. In other areas, traditional insurers won’t be at the ecosystem’s center no matter what they do, and they will have to find other ways of creating value. Picking the right position in the ecosystem will require scenario analysis, fresh thinking, and the ability to place and manage multiple bets.

- **New Innovation Models.** Traditional players will need to become more flexible and make learning a priority. They may be able to achieve these goals by doing more of their product-development work outside of their core organizations, perhaps using a corporate venture-capital model. This could allow insurers to surmount some of the challenges inherent in their own organizations. The products developed by these spin-off ventures could be reincorporated into companies’ portfolios, or they could remain external and be marketed by a new entity, depending on which approach makes the most sense.

- **Products and Services That Are More Consumer-Centric.** While no one yet knows which new products will become popular, the insurance offers that consumers will have access to will clearly be very different from those available today. For insurers, the key is to reimagine the whole consumer experience. Companies that do this well may find that they are able to engage their customers in ways that have previously been impossible. With its Facebook-like features, Oscar’s website has achieved a level of “stickiness” that is rare in the insurance industry. Approximately 5 percent of Oscar’s customers return to the site on a daily basis—quite a feat in an industry where consumer interactions rarely occur more than once a month and sometimes happen as infrequently as once a year.

- **The Need to Modernize IT During a Period of Rapid Change.** When it comes to their technology infrastructures, traditional insurers are caught in a difficult spot. On one hand, they need to be able to start delivering some of the benefits of digital technology to their customers quickly. On the other hand, they are sitting on top of legacy systems which, by their nature, can be changed only through a prolonged, multistep process.

The answer is a two-speed IT transformation, which means rolling out some new digital services even as insurers move toward a long-term overhaul of their legacy architectures. This is a difficult balancing act for most IT departments. IT orthodoxy often calls for investing in big-bang projects that can take years to complete. Given the current level of change in the industry, an insurer would be ill advised to pin all its hopes on one big-bang initiative. Instead, the company must have secondary and tertiary initiatives that are already producing returns.

**While predicting the exact timing is impossible, we expect that the impact**
of digitization will hit the insurance industry with full force in the next three to five years. Developing a roadmap now will help insurers preserve flexibility and give them a chance of winning no matter what comes—and when.

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For more perspectives on digital technology and insurance, please please visit www.bcgperspectives.com/digital_insurance.
INSURERS KNOW THAT LEAN processes make for satisfied customers, but many grapple with the basic challenge of how best to create them. The demands of insurance customers are increasing when it comes to speed of processing and quality of service, and the payoff from delivering on those demands is growing in kind, given how important positive customer experiences and recommendations are these days in winning new business. Simple and lean processes are not just a significant factor in cost competition but also the foundation for superior service quality and long-term customer retention.

The industry faces a number of specific challenges in attaining this ideal. Many processes involving sales, administrative work, and external partners have developed over long periods and have become correspondingly complex. At the same time, media usage habits now require new access channels, which need to be integrated without increasing complexity even further. The same goes for introducing new products and pricing or integrating company businesses by making acquisitions or merging. Ultimately, the continued cost pressure is forcing the entire industry to keep increasing efficiency just as demands for quality and service are growing.

It is therefore no surprise that almost all insurance companies have launched optimization programs under the heading of “lean” in recent years. But it is also little wonder that these efforts have achieved varying degrees of success. The fact is that many insurance companies are still spending a great deal more than necessary, and the costs are adding up as due of application processes. (See Exhibit 1.) In the case of property and casualty (nonmotor) policies, that equates to eight minutes of actual working time every six days. The shortcomings often stem from lack of scope and input. For instance, many companies elect to optimize single processes or departments. In very few cases do they evaluate and improve their processes on the basis of customer perspectives and with lean principles integrated throughout the organization.

Enter Lean 2.0, a modern take on the production efficiency philosophy that creates leaner, stronger, and more customer-oriented processes. Lean 2.0 establishes a way of looking at activities within the company so that waste can be identified where it occurs and improvements are integrated into everyday work to improve quality and the customer’s experience.
With Lean 2.0, the customer may be an end consumer or the internal organization. What matters is that processes are viewed holistically, or “end to end.” (See the sidebar “Five Practical Ideas for Your Lean 2.0 Program.”)

If Lean 2.0 is to be more than a buzzword for further management discipline—and if it is to yield greater customer and employee satisfaction on a sustainable basis—then insurers should actively consider what has worked for other companies on the road to becoming a lean company. Companies that have been successful in this respect have dutifully considered and answered four basic questions before setting the wheels in motion.

What are our objectives? “Less waste, more customer focus” is an understandable desire. But if you want to be successful with a Lean 2.0 program, you need specific and ambitious targets for an improved customer experience, higher employee involvement, and real economic benefits. Companies should compare their present standing with where they want to be positioned in the future, whether that’s next year or three to five years from now. Our experience has revealed that processes can be 15 to 30 percent more efficient in as few as 12 months and that most of these savings can be realized with little or no adjustments to IT infrastructure.

The targets of a Lean 2.0 program, however, must entail more than just mere process improvements. Processes can be 15 to 30 percent more efficient in as few as 12 months.

They need to include prospects for slimming down the business model, the organization structure, or the IT architecture. Programs without specifically defined financial, customer, and employee targets quickly lose momentum and run the risk of losing traction as time goes on.

In this context, assessing priorities and translating set targets into subtargets and project steps are tasks for management. Typical problems that insurers have battled with—for instance, deciding between quicker claims processing to increase customer satisfaction and making sure claims are valid in the first place—ultimately fall on management’s ability to get involved and make consistent decisions.

Where do we start? Nothing is as convincing as concrete results when it comes to establishing internal support for lean efforts. Pilot projects are a recommended way to demonstrate the advantages of a Lean 2.0 program and build momentum for further action. The processes picked for pilot treatment should cover multiple organizational units to demonstrate the overall effect of lean processes. They should also be highly relevant to the organization—meaning they exhibit high frequency and capacity, such as those supporting claims—and they should show the potential for savings barring any IT investment. While each pilot should be tailored to the company’s specific needs, there are typical “hot spots” of waste in insurance companies that are ripe

**EXHIBIT 1 | WAITING TIME TYPICALLY TAKES UP 95 TO 99 PERCENT OF THE APPLICATION PROCESS**

<table>
<thead>
<tr>
<th>Property and casualty (nonmotor) applications</th>
<th>Motor applications</th>
<th>Health applications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross working time</td>
<td>Gross working time</td>
<td>Gross working time</td>
</tr>
<tr>
<td>8 minutes</td>
<td>20 minutes</td>
<td>3.5 hours</td>
</tr>
<tr>
<td>6 days</td>
<td>6 days</td>
<td>9 days</td>
</tr>
<tr>
<td>Waiting time</td>
<td>Waiting time</td>
<td>Waiting time</td>
</tr>
<tr>
<td>99 percent</td>
<td>99 percent</td>
<td>95 percent</td>
</tr>
</tbody>
</table>

Significant room to improve the customer experience

Source: BCG analysis.
FIVE PRACTICAL IDEAS FOR YOUR LEAN 2.0 PROGRAM

Five factors are essential to the success of Lean 2.0 programs:

- **Customer Orientation.** Improvements should be seen from the customer’s perspective to ensure that the organization does not revert to its past practice of optimizing single processes or departments.

- **Performance Tracking.** A central contact point should monitor compliance with priorities and support sustained progress.

- **Specific Targets.** It must be clear what the program should achieve—both strategically and financially.

- **Pragmatism.** Not every problem needs to be addressed with a big solution; many little steps are often more successful in delivering long-term integration and savings.

- **Skills Growth.** Employees who acquire new skills or develop new competencies during the lean program should be recognized accordingly (for example, through certification) in order to create a network of lean “messengers” and foster a lean culture.

How can we reach the entire organization? After a successful pilot phase, the expansion of the Lean 2.0 program can begin—without shying away from “sacred cows.” Management must make clear decisions about which processes have high, medium, or low priority and should use benchmarks and expert opinions to identify processes that are especially in need of improvement. As the program expands, skills will be developed on the job—with employees acquiring know-how by actively working on projects—and shared and sharpened through training measures.

In the initial phase, a dedicated team should serve as a competence center, composed of lean experts from the pilot phase who have since returned to their respective units to apply their knowledge.

### EXHIBIT 2 | The Insurance Process Includes Hot Spots That Often Exhibit the Most Waste

<table>
<thead>
<tr>
<th>Sales</th>
<th>Applications</th>
<th>Contract management</th>
<th>Claims</th>
<th>Support functions</th>
<th>Marketing</th>
<th>IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales support</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Marketing strategy</td>
<td>Portfolio prioritization/management</td>
</tr>
<tr>
<td>Distribution control</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Advertising</td>
<td>Application development</td>
</tr>
<tr>
<td>Sales partner administration</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Application development</td>
<td></td>
</tr>
<tr>
<td>Commissions accounting</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Infrastructure</td>
<td></td>
</tr>
</tbody>
</table>

**General operations**
- Mail processing
- Cross-segment of simple transactions

**Segment-specific operations**
- Complex claims
- Personal injury
- Fraud
- Product development
- Segment strategy

**Communications**
- Legal/audit
- Facility management
- Logistics
- Asset management
- Reinsurance
- Tax and accounting

Source: BCG analysis.

**Note:** Red areas represent operations that typically have the greatest improvement opportunity for applying lean practices. This does not represent a complete landscape—only a selection of the largest processes shown. Processes that involve the sales field force are only shown if they are part of back office processes.
there. By rotating trained employees, Lean 2.0 approaches can spread throughout the company. Companies can further support these goals and underscore the importance of lean initiatives by making experience with lean programs a prerequisite for certain management positions. The goal is to gradually have the lean culture internalized in the company so that it is part of everyone’s daily routine.

How can we ensure that change is substantial? Ultimately, any Lean 2.0 program should pay for itself. For that to happen, organizations need certain prerequisites: a dynamic network of employees who have experience with lean, an infrastructure with appropriate tools and methods, and clearly articulated arguments from senior leaders for simplifying processes, effectively communicating management’s expectations of a Lean 2.0 program, and actively collaborating to implement changes. Lean leadership is about the continued involvement of the company’s top performers in the program—and about defining a framework for success so that progress can be monitored and can form the foundation of a comprehensive and continuous dialogue about quality and cost.

Lean 2.0 isn’t a onetime feat used to optimize processes for short-term successes. Rather, it seeks long-term transformation by recognizing that all activities that generate waste and do not add value only serve to weaken the company. Each and every employee shares responsibility for improvement by making problems visible and treating them at their root instead of simply allaying the symptoms. In the end, Lean 2.0 programs are successful when organizations show a willingness to rethink behavior on a fundamental level and, if necessary, effect a forward-thinking cultural change.

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Over the next few years, European policymakers will tighten regulations governing insurance distribution. Three regulatory initiatives—the Insurance Mediation Directive (IMD2), Packaged Retail and Insurance-Based Insurance Products (PRIIPs), and the Markets in Financial Instruments Directive (MiFID2)—will change how insurance is sold and how insurance products are structured. While all forms of insurance will be affected, life insurance faces the most shifts. Some of the regulations are still taking shape. However, the high-level goal of the pending changes is clear. Regulators want to accomplish the following:

- **Extend and raise advisory standards.** This means that before an insurance product can be sold to a customer, the intermediary must do a detailed “customer fit” analysis, similar to what banks and asset managers have to go through to sell complex investment products. It will also involve more extensive documentation.

- **Require intermediaries to disclose their individual remuneration.** In the past, the amount of money an intermediary made from selling a particular product has been invisible to the customer. In the next regulatory era, that will likely change. If a customer knew, for instance, that an intermediary would earn a €1,000 commission for selling a particular product, the dynamics of their relationship might be affected.

- **Increase sanctions and personal liability for misconduct or failure to comply with insurance rules.** Such sanctions will affect not just intermediaries but also the insurance companies and the managers who run them.

- **Raise the minimum qualifications of intermediaries by requiring them to regularly take more formal and stricter exams.** In countries where standardized qualification requirements are already in place, increases in minimum qualifications won’t hit as hard as it will in other places.

- **Ban product “tying.”** Today, in many places, an insurer can make a loan contingent on the purchase of payment protection insurance. That’s just one example of the kind of loan requirement that might be forbidden under the new rules. Regulators want to remove obstacles that keep consumers from shopping for better or more affordable options.

We think of the changes, collectively, as a realistic worst-case scenario for which every European insurer should prepare. To get a detailed sense of what the changes will mean, The Boston Consulting Group and financial-research
company Sanford C. Bernstein conducted an analysis of the top-line impact of pending regulations on several European markets.

To establish a context, we consider Germany first. German markets for life and health insurance will probably decline by about 15 percent and 8 percent, respectively, as a result of the new regulations. (See Exhibit 1.) Here’s more detail on what we see happening.

- **In Germany,** *tied agents* (those who sell insurance products of a particular company or companies and are not free to offer products of other companies) will suffer a decline in productivity—although the impact will vary. Agent networks that aren’t fully dependent on life insurance or already provide sophisticated holistic advice (which may be required) will fare better than average; life-focused “push” networks will fare worse.

- **Brokers,** or independent advisors, will be affected by the same dynamics as their tied peers. But they will fare slightly better, because brokers already leverage holistic and automated advisory tools to a greater extent than tied agents do today.

- **Even though the decline in productivity will be less severe in bancassurance—insurance products offered by banks to their customers—it will lose significant market share. There are two reasons for this. First,** many German banks already operate at low levels of profitability, and the introduction of new regulations will cause the mass-market insurance products they sell to become even less profitable. **Second,** at the high end of the market, banks will try harder to sell their own asset-management products instead of newly regulated insurance products.

- **Direct-sales channels** in Germany will gain substantially from today’s small base. But this gain will not all go to websites of purely direct insurers. Existing insurers that are able to combine self-service direct models with additional forms of assistance—such as advice by phone or integration with salaried sales forces—will also benefit from this growth.

In addition to analyzing the market in Germany, we looked at Italy, Spain, France, and the UK. (See Exhibit 2.) We expect an overall revenue decline of about 6 percent

**EXHIBIT 1 | Regulation Will Significantly Affect the Top Line in Germany**

<table>
<thead>
<tr>
<th>Life insurance</th>
<th>Property and casualty insurance</th>
<th>Health insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>New business premium (€billions)</td>
<td>Gross written premium (€billions)</td>
<td>New business premium (€billions)</td>
</tr>
<tr>
<td>Before regulations</td>
<td>Base scenario</td>
<td>After IMD2</td>
</tr>
<tr>
<td>----------------</td>
<td>-------------</td>
<td>----------</td>
</tr>
<tr>
<td>−15% in individual life insurance, −5% in group life insurance</td>
<td>22.3</td>
<td>−2.5</td>
</tr>
<tr>
<td>18.2</td>
<td>−0.2</td>
<td>15.9</td>
</tr>
<tr>
<td>4.1</td>
<td>2.8</td>
<td>3.9</td>
</tr>
</tbody>
</table>

**Sources:** Expert interviews; Insurance Mediation Directive (IMD2) and Packaged Retail and Insurance-based Insurance Products (PRIIPs) impact model; BCG analysis.

³Five years after the introduction of IMD2.
in individual life insurance. Initially, this might not seem to be so dramatic, but declines in volume will differ significantly among the various countries and sales channels, as will the impact on individual market participants.

Declines in volume will differ among the various countries and sales channels.

The following summarizes how the base scenario might play out in Europe:

**Italy.** The overall impact on Italy will be similar to that on Germany’s market, with differences in certain channels. In particular, the Italian bancassurance channel—which is extremely important because it makes up about half of the Italian life-insurance market—will probably hold up better than in Germany, where it accounts for about 20 percent of the market. But we expect a slightly bigger impact on Italian tied agents (16 percent market share) and brokers (29 percent market share), since these sales channels will have further to go in terms of complying with new rules and offering a level of advice for which customers are willing to pay.

**Spain.** The impact on Spanish agents and brokers is expected to be similar to that in Germany. However, we expect the Spanish bancassurance channel, whose share of the life insurance business is approximately 80 percent, to hold up relatively well in the medium term. There are a few reasons for this, including the extent to which banks in Spain need to simplify their balance sheets, and they are, therefore, going to be less enthusiastic about selling their own asset-management products. In addition, Spanish retail-banking networks still suffer from significant overcapacity. This will make it easier for Spanish than for German or Italian banks to handle increased documentation and advisory requirements—at least until this overcapacity has been reduced (which may happen after the implementation of IMD2 and PRIIPs).

**France.** French brokers (who have a 12 percent market-channel share) and tied agents (7 percent market share) will be affected by the same dynamics and to a similar extent as their German counterparts. But the bancassurance channel (which makes up about 60 percent of the French individual-life-insurance market) will fare much better.

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**EXHIBIT 2 | Regulatory Impact Will Vary by Country and Channel**

<table>
<thead>
<tr>
<th>Country</th>
<th>Tied agents</th>
<th>Brokers</th>
<th>Bancassurance</th>
<th>Direct</th>
<th>Others</th>
<th>Total change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>–10 to –20</td>
<td>–10 to –20</td>
<td>–5 to –10</td>
<td>+125 to 175</td>
<td>–10 to –20</td>
<td>–8</td>
</tr>
<tr>
<td>France</td>
<td>–10 to –15</td>
<td>–10 to –15</td>
<td>0 to –5</td>
<td>+80 to 120</td>
<td>–10 to –20</td>
<td>–5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0 to –5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Sources:** Interviews with insurance executives from the respective countries; IMD2 and PRIIPs impact model; BCG analysis.
When it comes to selling life insurance, French banks are already largely out of the mass market. Moreover, the revenues and profits these banks amass by selling life insurance to affluent customers are simply too significant for them to give up. The long and short of it is that asset management products don’t currently have the same replacement potential in France that they have in other markets. For this reason, the top-line threat to insurers is less severe and probably farther off in France than elsewhere.

**UK.** British insurers have already had to adapt to national regulations that have moved faster and been more severe than those taking shape at the pan-European level. The EU regulations will have minimal impact on most UK insurers for the same reason that tossing a bucket of water on someone who has just emerged from a swim in the ocean doesn’t have much impact. The only channel in the UK that is likely to be affected in a negative way is the already-decimated broker channel, which may thin out some more because of increased documentation requirements. Any loss in volume here, however, will likely be made up by more business in the direct channel.

The numbers and country dynamics discussed above are just averages; they aren’t foreordained outcomes. Insurers that take some smart preparatory steps have a chance to sidestep the harshest impact of the coming regulations and can position themselves to succeed in the new world.

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Six years after the global financial crisis, the reshaped contours of the market for the life insurance industry are coming into focus. As with any other turn of events, threats and opportunities abound.

The threats—notably low interest rates, regulatory scrutiny, customer concerns, and rising competition from banks, mutual funds, and other asset managers—should not obscure the sizable and growing opportunities.

Demographics and technology are all friendly forces for the industry. Insurers are well poised to help older people manage their assets in mature markets, especially as the government’s role in providing retirement income shrinks. In emerging markets, insurers can cater to the desire of the expanding middle class to save and plan for the future. Digital and mobile technologies are opening new, low-cost channels to consumers in all markets. (See Exhibit 1.)

This new environment will produce winners and losers. To under-

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**EXHIBIT 1 | The Opportunities and Threats for Life Insurers**

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Aging population</strong></td>
<td><strong>Low interest rates</strong></td>
</tr>
<tr>
<td>• Rising need for retirement products</td>
<td>• Increasing pressure on profitability and costs</td>
</tr>
<tr>
<td>• Greater awareness of changing needs because</td>
<td>• Worsening value proposition of insurers</td>
</tr>
<tr>
<td>of increasing longevity</td>
<td></td>
</tr>
<tr>
<td><strong>Reduced support by governments and employers</strong></td>
<td><strong>Increasing regulatory scrutiny</strong></td>
</tr>
<tr>
<td>• Lower government pensions</td>
<td>• Strengthening new rules for capital</td>
</tr>
<tr>
<td>• Rising need for individual retirement products</td>
<td>• Greater regulation of sales and conduct</td>
</tr>
<tr>
<td><strong>Digitalization</strong></td>
<td><strong>Growing customer concerns</strong></td>
</tr>
<tr>
<td>• Access to new customer segments</td>
<td>• Selling scandals and loss of trust</td>
</tr>
<tr>
<td>• Need to reformulate personal advice</td>
<td>• Increasing demand for transparency</td>
</tr>
<tr>
<td><strong>Future customers</strong></td>
<td><strong>Competition from alternative providers</strong></td>
</tr>
<tr>
<td>• Emerging middle class</td>
<td>• Banks with more flexible forms of savings</td>
</tr>
<tr>
<td>• Demand for simple savings and protection</td>
<td>• Asset managers offering retirement products</td>
</tr>
</tbody>
</table>

Implications for life insurers
- Driver of profitability and growth
- Shift in response to changing customer and distribution requirements

Source: BCG analysis.
stand what will separate the winners from the pack, we recently concluded a comprehensive global study of the life insurance industry.

As part of our research, we interviewed senior executives in the 16 markets that generate 80 percent of global life-insurance premiums.

We detected five trends that will drive success in the future. Two of them describe how the design of products can improve profitability:

- Creating savings products without guarantees
- Tailoring protection products to untapped segments

Three trends respond to shifting consumer needs and behavior and changing distribution capabilities:

- Simplifying products and sales approaches for the mass market
- Customizing, without complicating, products for the affluent market
- Tapping the workplace as a new distribution channel

These global trends have not taken hold equally in the 16 markets we studied, but they will blossom throughout most of the global insurance marketplace in the coming years. (See Exhibit 2.) The insurers that understand these trends and act quickly to develop products that respond to them will be able to overcome the well-publicized threats facing their industry and surf on the waves of opportunities that demographics and technology provide.

Creating Savings Products Without Guarantees

For decades, insurers relied on guaranteed savings products that offered high, stable returns, which appealed to customers looking for good yields and security upon retirement. Those days are dwindling. Falling interest rates and rising capital requirements prevent insurers from offering generous guarantees and are forcing them to rethink the savings proposition.

Asset management remains one of the most important strengths of insurers, but they now need to engineer financial solutions that provide assurances—rather than guarantees—of solid, steady, long-term performance. In this new environment, insurers still have two strong advantages over traditional asset managers and banks: their reputation and their distribution networks, both of which they can use to promote new offers to retail customers.

The Standard Life Investments Global Absolute Return Strategies
The Boston Consulting Group | 19

Fund is an example of this type of solution. From 2008 through 2013, the UK fund exceeded its target return of 5 percentage points over the six-month London Interbank Offered Rate by 3.6 percent annually. This performance, coupled with low volatility, has attracted investors. Assets have increased from £1 billion in 2008 to £20 billion in 2013, despite annual fees exceeding 1.5 percent for retail investors and no guarantee of returns. The fund takes both long and short positions globally and invests judiciously in derivatives to generate returns and minimize risk.

Swiss Life Premium Immo, another successful product without explicit guarantees, invests in commercial real estate in Switzerland and expects to earn around 4 percent annual returns after fees. Investors view the fund as an attractive alternative to purely financial products. Founded in 1857, Swiss Life, the nation's largest and oldest life insurer, is able to draw on the strength of its brand to introduce new product lines.

Moving into a world without guarantees has challenges. The new products will be similar to those offered by mutual funds and banks, and insurers will have to learn how to compete against these institutions. In addition to drawing on their brand and distribution capabilities, insurers will need to deploy sophisticated asset-management tools, such as dynamic portfolio rebalancing and hedging. Explaining these techniques to their sales forces, independent financial advisors, and customers may be challenging. Communication, marketing, and clear product descriptions will become more important than ever.

Tailoring Protection Products to Untapped Segments

As margins deteriorate for traditional savings products, protection products—such as term life insurance, disability insurance, and annuities—are becoming relatively more attractive to insurers. They provide new sources of income, generate steady margins, and diversify risks. Under new capital standards, such as the European Union's Solvency II directive, this diversification can help minimize capital requirements.

In emerging markets, the middle class has a growing appetite for protection products.

These products appeal to two large sources of relatively untapped demand: emerging markets and the low-income segments of mature markets. In emerging markets, the middle class has a growing appetite for protection products, while the low end in mature markets has historically been underserved. In all markets with an aging population, consumers are recognizing the value of products that offer steady retirement income and other services in old age. To broaden their offerings and increase margins, insurers increasingly embed additional services in protection products.

In China, for example, Taikang Life has created an innovative annuity that provides retirees with an apartment for life and optional medical care and other features. The product is aimed at older affluent consumers who are able to pay a large, single-contribution premium. The company plans to sell about 50,000 policies over ten years; 2,000 were sold in the first six months.

This new product enables Taikang Life to build a new revenue source and compete against banks. Other insurers are preparing to offer similar products. The winners will successfully pull together marketing, sales force training, and real estate expertise into an attractive package.

In South Korea, Hyundai Life responded to many consumers' perceptions that life insurance products are too expensive and confusing by offering an à la carte health-protection policy called Hyundai Life Zero. Customers can pick the particular risks, such as cancer, that they want to cover at a fraction of the cost of comprehensive, long-term health-care policies. And the benefits of the plan are so simple to understand that it is offered online and by phone in addition to traditional channels. The insurer sold 15,000 policies in the product's first six months.

Despite their appeal, however, such products take insurers out of their comfort zone. Insurers do not have deep experience in many of these segments, so risk assessment and pricing—as well as developing low-cost sales channels—will be crucial. Since many of these products will offer coverage that is less than comprehensive, insurers must make sure that communications about coverage are clear and be prepared to manage risk and litigation.

Simplifying Products and Sales Approaches for the Mass Market

Several forces are combining to encourage product simplification and
streamlining. First, regulatory moves, such as the European Union’s Insurance Mediation Directive, will impose greater expense, liability, and oversight on traditional products. Those products sold without the need for advice from an agent or sales executive will escape these burdens.

Second, declining returns have reduced insurers’ ability to finance expensive channels with high management fees, especially for savings products.

Finally, consumers’ buying preferences have changed, too, shifting toward online and direct channels. While such routes are less costly and widen the access of insurers to consumers, new products offered through these channels must be sufficiently simple to be sold without advice.

Insurers need to do more than simply strip away features from existing products. They need to build products that appeal to specific customer segments and that can be sold through direct sales channels. Online marketing material will also need to be simple, transparent, and interactive and be designed to appeal to specific segments.

The online channel will explode with innovation over the next several years. One likely avenue of experimentation will be automated and algorithmic advice that directs potential customers to specific products depending on those individuals’ answers to questions.

Scottish Friendly, for example, has created a suite of tax-advantaged individual savings accounts that appeal to specific consumer segments. Each account offers varying levels of choice and financial risk tailored to the sophistication of the customer.

Online marketing material for each account is based on simple graphics, checklists, and descriptions. Telephone support is also available. These accounts helped to double Scottish Friendly’s sales in 2013, the first year that they were offered.

Metropolitan Life, the largest U.S. insurer, is pursuing the mass market by offering term life insurance in a box through Wal-Mart stores. Snoopy, the lovable dog in the Peanuts comic strip, is featured prominently in the in-store marketing material. The policies are available with coverage as low as $10,000, opening the low-income market to insurance products. Customers activate the policies by calling a toll-free phone number and answering simple eligibility and health questions.

For an industry known for complex products, the trend toward simplification presents several challenges. Insurers will need to sharpen their skills in consumer insight to identify the most attractive features and benefits for specific segments. The new products will also need to be successfully integrated into insurers’ distribution networks without alienating the existing sales forces.

Insurers must address the hybrid needs of more savvy consumers, who often seek streamlined, simple products and services for a specific need—such as life or accident insurance or savings—but still require some support during sales and service. Such a multichannel approach could combine the best of worlds by leveraging simplicity and personalization.

Customizing, Without Complicating, Products for the Affluent Market

Simplification is a smart strategy for new and low-end insurance customers, but it is generally unsuitable for the affluent segment. These customers have the means and the desire to pay for advice, customization, and more advanced financial-savings products. Despite changes in the industry, the best financial advisors still have a role to play and can actually increase their earnings by focusing on affluent customers and sophisticated products.

Italy’s Assicurazioni Generali designed a three-phase product for German consumers in their fifties who want to maintain flexibility at the start of their policy and receive protection and benefits as they enter retirement. During the first two years, the policies are fully liquid. In the second phase through retirement, withdrawals are still allowed. In the third phase, the product converts to an annuity. Long-term care and critical-illness riders are available. The product was so successful at launch, taking in €1.5 billion in premiums in 2011 and 2012, that Generali had to impose sales and production measures to manage capital.

Insurers should not go crazy with customization, or they will land in an economic trap. Instead, they should rely on stringent economic calculation and rigorous customer needs and the desire to pay for advice, customization, and more advanced financial-savings products. Despite changes in the industry, the best financial advisors still have a role to play and can actually increase their earnings by focusing on affluent customers and sophisticated products.

For an industry known for complex products, the trend toward simplification presents several challenges. Insurers will need to sharpen their skills in consumer insight to identify the most attractive features and benefits for specific segments. The new products will also need to be successfully integrated into insurers’ distribution networks without alienating the existing sales forces.

Insurers should not go crazy with customization, or they will land in an economic trap.
segmentation to provide varying levels of customization. For example, the mind-set and expectations of a customer whose net worth is $500,000 may be similar to those of a customer whose net worth is $10 million—but they have very different financial needs. Insurers will also need to allow agents to customize without creating unnecessary complexity—or risk overwhelming both agents and customers.

Tapping the Workplace as a New Distribution Channel

In many markets, consumers have grown frustrated with the increasing complexity of life insurance products and the lack of transparency and questionable sales practices of insurers themselves. These consumers have gravitated toward other savings products, such as bank accounts, mutual funds, and employers’ savings plans. Meanwhile, regulators have encouraged employees to save for retirement by supporting auto enrollment in their companies’ plans and providing tax benefits that promote participation.

These trends have helped raise the importance of using the workplace as a sales channel. Insurers may now integrate several insurance and savings offers into one customer-friendly package that carries the employer’s stamp of approval. Insurers have offered basic life and disability insurance through the workplace for a long time already. But they now offer a much wider range of products and services and developing an integrated workplace-marketing machine that combines industry-specific expertise with scale and technology.

Insurers are able to leverage their expertise in relevant industries and product areas, such as income protection; provide products aimed at specific occupational groups; and offer other services. In the UK, Unum, a specialist in financial protection products, offers a suite of products through the workplace. These include income protection insurance, which provides a rehabilitation program to help employees return to work, and a program called Unum LifeWorks, which provides legal, lifestyle, and fitness assistance for employees.

Insurers can also leverage their long-term relationships with employers to position themselves in the role of orchestrator, providing employees with a range of products and services from several insurers. Aon Hewitt, a benefits advisor, has created an insurance marketplace for employees at large U.S. corporations, allowing them to shop from a range of products offered by several insurers. Life insurers are also well positioned to organize private marketplaces in the workplace.

**Conventional Wisdom is Wrong.** There is growth potential in the life insurance business. So long as people are averse to risk, demand for insurance will remain. However, insurers will not be able to grow in the same way they have in the past, positioning themselves as pure financial organizations and relying on asset returns to solve all their problems. They will have to challenge both their business models and the way they operate in order to ride the waves created by these five trends.

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THE COMMERCIAL-INSURANCE AND REINSURANCE MARKETS
LONDON VERSUS THE WORLD

More than 350 market participants operate within 400 meters of Lime Street

Currently the largest global hub for commercial and specialty risk, controlling more than £60 billion in gross written premiums in 2013

Controlled or marketed by London: £15 billion
Written by London: £45 billion

Reinsurance Commercial insurance

Market size: £4 billion (growth rate: 13%) Market size: £19 billion (growth rate: 5%) Market size: £25 billion (growth rate: 4%) Overall size: £60 billion (growth rate: 4%)

Singapore Switzerland Bermuda London

As an industry, it insures all conceivable types of risk

It also insures bespoke risks such as the following:

For one F1 driver, up to $50 million
Cristiano Ronaldo’s legs $144 million
Bruce Springsteen’s voice $6 million
The Oscars jewelry $27 million
Costa Coffee taster’s tongue £10 million

The market is a substantial contributor to the London economy

21% of the city’s GDP

8% of London’s GDP in 2013

It employs 48,000 people…

34,000 professionals in London

Another 14,000 work for London market companies in the UK, but outside of London

… and supports the broader global economy by paying large claims every year

Deepwater Horizon 2010
$600 million

Japanese earthquake and tsunami 2011
$1.95 billion

New Zealand earthquake 2011
$1.2 billion

Australian floods 2011
$650 million

More than £140 billion paid in claims in the past five years
However, London’s unique position is under threat

London is tracking market growth only in commercial insurance, while it is losing share in reinsurance

- Losing share in energy (−3%) and reinsurance (−2%)
- Tracking share in casualty, property, motor, and marine
- Gaining share in aviation (+8%) and other (+1%)

In addition, London is not keeping pace with emerging-market growth: its share declined from 2013 through 2014
This translates into six challenges to London’s position...

1. London needs to meet substantial unmet demand for new products and solutions, building on its reputation for innovation and flexibility in order to offset the commoditization of more traditional risks.

2. London does not have a strong position in emerging markets, and its share of business in these markets declined by more than 20%—from 3.2% in 2010 to 2.5% in 2013.

3. London is losing share in reinsurance (from a 15% share in 2010 to a 13% share in 2013) as purchasing is increasingly centralized and emerging-market growth gains importance.

4. London’s expense ratios were 9 percentage points higher than those of its peers in 2013—driven by higher acquisition and transaction costs—putting it at a price disadvantage for more price-sensitive risks.

5. The comparatively high regulatory burden on London market participants raises costs and could put London at a further price disadvantage should the burden become greater than the value of regulation to customers.

6. The prolonged soft-market cycle, propagated by the superabundance of capital and securitization of insurance risk, challenges London’s role as the supplier of additional capacity to meet local needs.
... and six opportunities for London to enhance its position

1. London can meet substantial unmet demand for new products and solutions, building on its reputation for innovation and flexibility in order to offset the commoditization of more traditional risks.

2. London can reinforce its strength in expertise-based underwriting with improved analytical techniques to deliver value to customers, enable better selection of risk, and help retain more commoditized business.

3. It can invest in marketing the strengths of the London market—particularly in emerging markets—to stimulate customer demand and encourage brokers and carriers to remove barriers to placement.

4. London can break down barriers to reinsurance and intermediation and develop the distribution network, creating an appropriate local presence that will allow it to compete more effectively in high-growth markets.

5. It can reduce the cost of doing business by delivering on infrastructure activities, removing London-specific processes and realizing economies of shared service to increase competitiveness for commoditized risk.

6. London can embrace the rise of alternative capital in order to take advantage of deep capital markets, build capacity in capital-scarce lines, and protect against extended soft-market cycles.
INSURANCE COMPANY ASSET MANAGERS ATTACK THE TARGET-OPERATING-MODEL OPPORTUNITY

By Gary Shub, Simon Bartletta, Brent Beardsley, Hélène Donnadieu, Renaud Fages, Craig Hapelt, Benoît Macé, Andy Maguire, and Tjun Tang

Intense and persistent cost-cutting pressure is among the chief obstacles inherited from their corporate parents. Needed resources are perpetually shoved to the back burner. Capability development is undermined. In operations and IT, managers face a cost squeeze that makes it difficult to address critical concerns.

Now a few leading insurers are stepping back to revamp their asset-management units and redesign their operating models. They are doing this, in part, to provide support for the core front-office business, including the flexibility to manage new products and tools to help investment professionals perform. Furthermore, they aim to achieve better management of both operational and investment risk. Also, these efforts promote greater cost-effectiveness.

Insurance company assets compose nearly 20 percent of the global total. Insurers’ total AuM reached $13 trillion in 2013. Yet their AuM growth of 7 percent in 2013 was far lower than the overall average 13 percent increase in AuM.

There are several reasons for insurers’ slower asset growth. First, most insurers have been affected by slower-growing inflows from the liability-producing insurance side, driving net outflows of 0.5 percent, relative to total market net inflows of 1.6 percent. Second, because insurance companies typically hold a large proportion of fixed-income assets in their portfolios, they did not benefit as much from the global surge in equity markets. Last, their exposure to high-growth specialties was similarly limited. Insurers must decide which of the following hurdles they need to overcome.

Organizational impediments have created or sustained asset-management inefficiencies. These include regional fragmentation—an artifact of historical organization ties to the insurance company’s sources of cash and liability. The asset managers of most insurers operate in regional silos as well as asset class silos, exacerbating fragmentation and complexity.

Structural and role impediments abound. Low transfer pricing, for example, caused by the historically strong political pull of the insurance units, has skewed asset management economics and allowed lower investment levels in managers’ capabilities. This bias
can lead to a penny-wise-and-pound-foolish approach to investing in front-office resources and capabilities and to supporting talent, operations, and IT. For instance, independent asset managers typically spend more to research an investment than does the insurance company that bears the direct benefit or burden of the investment’s outcome.

Insurers struggle to manage new complexity created in expanding their third-party offerings. While insurers’ asset managers have not historically focused on profitability and growth, they are tempted by the high returns on equity of third-party management. Some managers have built this business to more than a third of their activity and, in doing so, have invested and grown stronger commercially. As a result, they have achieved higher revenue margins and profits—averaging 25 basis points of revenues and 39 percent profitability, compared with 12 basis points and 26 percent, respectively, for mostly captive managers that focus predominantly on the insurer’s general account.

But achieving third-party growth generates new challenges, including greater operational complexity, for insurers’ asset managers. So far, they lag behind independent asset managers in operational efficiency. For instance, they have a significantly lower proportion of straight-through processes for both fixed-income and equity products.

Leading managers are actively working to create target operating models that address these challenges. They have moved beyond mechanical cost cutting to focus on creating differentiators, which range from organizational, process, and technology changes to commercialization in order to build scale.

The good news for these forward thinkers is that there is much to gain in efficiency and effectiveness, including higher investment returns and enhanced revenue streams, from the growth of third-party asset management.

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Many insurance companies are tapping into large, fast-moving, complex streams of big data and applying advanced analytical techniques to transform the way they do business. But in the life insurance industry, using big data seems to be low on the executive agenda.

Life insurance companies are taking a backseat approach to big data for many reasons. Perhaps the most important is that these companies have little available data to begin with. This is partly because they have limited interactions with customers and partly because a company usually does not get much additional data from a customer once an application for a life insurance product is completed. What's more, the data itself often involves significant issues of privacy, including health, behavioral, and lifestyle information that can be highly sensitive and, in some countries, tightly regulated. (See “Data Privacy by the Numbers,” BCG slideshow, February 2014).

Yet after conducting a comprehensive survey of the industry, we have found that forward-thinking life-insurance companies are overcoming these challenges through four growth strategies. Some are using big data and advanced analytics to improve business processes and expand into new markets, thereby generating significant revenues and profits. Others are building long-term, trusted relationships with customers. These insurers are offering valuable new or improved products and services in exchange for personal data that customers provide voluntarily. The new offerings may help clients improve their health or may provide access to insurance for people who are considered risky or expensive to serve.

The landscape is changing. Companies that get ahead of these shifts will discover new opportunities for efficiency, growth, and innovation.

Enhancing Business Processes. Big data and advanced analytical tools and techniques are already boosting operational performance significantly. Some companies, for example, have generated an increase of 5 to 15 percentage points in the placement rate, which measures how many people purchase a policy after beginning the application process. Other
companies have reduced the length of the application process from weeks to hours.

In underwriting, some insurers are improving risk assessment during the underwriting process by including more relevant big-data variables in existing analytical models. Aviva, for example, has experimented with selectively replacing costly and inconvenient medical exams with predictive modeling of risk based on enhanced data. A study of 60,000 Aviva applicants found that nontraditional data was as effective in identifying potential health risks as blood and urine tests.

In distribution, companies are improving agent recruiting and retention by developing predictive models to identify, select, and retain the best sales performers. In near real time, these companies track metrics such as early customer-lapse rates, disclosure rates (how much information an agent is able to obtain from an applicant), and average policy size. They also design incentives on the basis of these indicators in order to move performance in the right direction. What’s more, they provide agents with advanced sales-support tools. For instance, MassMutual Financial Group has developed a mobile app that highlights the customers who are most likely to buy a policy. The system has increased placement rates by 5 percent in 18 months.

Finally, in marketing, companies are using advanced analytics to better model both the likelihood of customers buying a product and the risk of customers cancelling coverage. These companies are

Increasing Market Penetration. Some companies are expanding into new markets with leaner, faster underwriting processes powered by big data and advanced analytics. They are even automating underwriting processes to lower costs, when relevant. This allows insurers and intermediaries to serve new market segments in a profitable way.

Consider, for example, how companies have sometimes been hesitant to sell to the middle market, often defined in the U.S. as households with annual incomes of $35,000 to $100,000. The contracts have traditionally been regarded as too time-consuming to underwrite, and the commissions they produced were too low. Yet the middle market represents billions of dollars in potential annual premiums and serves as a bridge to sales of other financial products, such as
annuities. Automating the underwriting and distribution processes for this segment reduces costs and allows companies to profitably sell products with lower margins.

SCOR Global Life, for instance, offers a real-time, fully automated underwriting solution called Velogica, which helps life insurers in the U.S. create affordable products for the largely underserved middle market. Decisions are communicated to an agent in less than a minute in 90 percent of cases, and fewer than 5 percent of applications require human intervention. A significant information asymmetry exists between insurers and customers. In the life insurance business, insignificant information asymmetry often means that insurers do not know much about a customer’s health over the life of a policy, and as a result they lack information about the evolution of the mortality risk. Policyholders, on the other hand, often know a great deal—but may not be willing to share it.

Consider how Discovery has circumvented this problem with a wellness and loyalty program called Vitality. Customers who subscribe to the insurer’s program enter information about their lifestyle and health-related behaviors, receive an annual health check, and take other tests to assess exercise, eating habits, and stress levels. Based on their participation in the program and changes they make to their behavior, customers receive Vitality points that they can redeem for discounts at a range of health, fitness, shopping, and leisure-activity partners. Customers who maintain their healthy habits also receive markedly better pricing on the company’s insurance products as an added incentive to sustain their prevention practices.

Customers benefit from discounts, rewards, and a personalized program to improve their health. Insurers gain by receiving a great deal more data to better select risks and generate higher retention and loyalty. And society is well served by the reduction of negative behaviors that account for the vast majority of expenditures related to health.

Discovery estimates that it has achieved a reduction in lapsed policies of as much as 52 percentage points and a reduction in mortality of as much as 34 percentage points for most active participants in the program. (See Exhibit 2.) In addition, the company estimates that Vitality has increased operating profits by almost a full percentage point. The program recently expanded beyond its original base in South Africa through partnerships with major insurance companies, such as Prudential in the UK, Humana in the U.S., Ping An Insurance in China, and AIA in Singapore and Australia.

Underwriting New Risks. A handful of companies are on the leading edge, using big data and advanced analytics to underwrite entirely new risks that previously could not be covered profitably and to increase the intensity of the customer relationship. Life insurers used to assess health risks just once, at sign-up, asking questions about lifestyle behaviors linked to a higher risk of mortality. Now, trusted insurers can access data regularly volunteered by high-risk customers in exchange for insurance that had at one point been unaffordable or unavailable.

AllLife provides affordable life and disability insurance to policyholders who suffer from manageable diseases, such as HIV and diabetes, and who agree to adhere to a strict medical protocol. Patients get monthly health checks and receive personalized advice on managing their conditions. With the client’s permission, data is pulled directly from medical providers. If a client does not follow the treatment protocol or discontinues treatment, benefits or coverage can be lowered or cancelled after an initial warning. The company assesses its risk every three to six months, rather than just once.

Clients who have participated in prevention programs have boosted

A handful of companies are using big data and advanced analytics to underwrite new risks.
their health and lengthened their life expectancies. Six months after enrollment, the immune systems of HIV patients, for example, improved by 15 percent on average—even without treatment. At the same time, AllLife benefits when clients take voluntary measures to reduce their risk and increase the flow of health information to the insurer.

The company is growing at an annual rate of 50 percent and aims to insure 300,000 HIV patients by 2016. An investor claims that AllLife’s model is highly profitable and that the company’s risk is not much higher for HIV clients than it is for clients who do not suffer from these diseases.

How Life Insurers Can Get Started
These strategies demonstrate that policyholders are indeed willing to share personal data with insurers in exchange for improved customer relationships, lower pricing, richer rewards, or previously unavailable or unaffordable coverage. When insurers add voluntary data from risk assessments (such as health exams) and nontraditional data sources (such as behavioral or unstructured data), they can significantly reduce the information asymmetry that exists between themselves and their customers. They can also open up vital new pathways for growth.

Companies can enhance their ability to generate competitive advantage from these strategies with the following actions.

Start with data-intensive business processes that have clear business potential. In the short term, insurers should focus on the “moments of truth” that occur in situations where companies already have a lot of contact with clients, such as underwriting, claims, and fraud detection. (See “Big Data: The Next Big Thing for Insurers?” BCG article, March 2013.)

Develop proprietary data. In an industry with limited information, the only way to build long-term advantage is to develop one’s own data sets. For instance, automakers using telemetric data from customers’ cars have built a unique value proposition that will be hard to displace. (See “Telematics: The Test for Insurers,” BCG article, December 2013.) Some insurers may gain an advantage working on their own, as Discovery has done. Others, depending on their size and existing capabilities, may need to rely on partnerships to some degree.

Break down information silos. Traditionally, analytical expertise has resided in the actuarial department. But it now often resides in other departments as well. The
ideal team should be able to cooperate across departments and should include marketing, actuarial, claims, data science, and legal functions. In some cases, companies may need to give an executive responsibility for exploring new avenues of product design and risk assessment through big data and advanced analytics.

**The truly transformative potential of these strategies will take time to play out. Over the long term, these approaches will open up important avenues for growth and innovation for companies willing to experiment now.**

Insurers that excel at these and other strategies to intensify the customer relationship and move into new markets will catch up to—or even surpass—more nimble companies that are already in the game. They will win the best clients, reduce risk, increase loyalty, and create more opportunities to cross-sell products and services.

The rest will risk falling behind or ceding the most attractive customer relationships and emerging markets to others.

**Build trust through mutual benefit.** In such a heavily regulated industry, companies must create trust with both consumers and regulators. Insurers must demonstrate how greater access to personal data produces clear advantages for both consumers and society through new products and services. (See *The Trust Advantage: How to Win with Big Data*, BCG Focus, November 2013.)

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NOTE TO THE READER