KPMG 2016 Insurance conference survey results report

Tech innovation will drive growth; it’s time to get onboard
Insurance executives focusing on growth in a challenging business environment see digitization of operational and financial processes—and alliances with savvy insure-tech third parties—as some of the keys to a more profitable and efficient future.

More than 300 executives at KPMG LLP’s 2016 Industry Conference (marking its 28th consecutive year) were surveyed on issues dealing with innovation, risks, business conditions, costs, and information technology (IT) investment plans.

The conference theme centered on sharing ideas on leveraging advances in technologies that are geared toward driving prospects for higher growth, lowering cost, and establishing closer relationships with a broader cross-section of customers in order to accelerate innovative ideas and improve top- and bottom-line results.

While optimistic about the tools and processes that can invigorate the industry, some expressed concern about near-term growth due to a general uncertainty about overall economic conditions.

They said they expect a drag on progress due to the prospect of continued low interest rates and accompanying stagnant investment yields, an uncertain regulatory environment driving up costs, and an ongoing situation where they are saddled with complex and costly legacy IT systems that stymie their ability to leverage data and analytic (D&A) techniques.

**Figure 1**

**Compared to a year ago, describe current industry business conditions**

<table>
<thead>
<tr>
<th>Category</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Much better</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Better</td>
<td>12%</td>
<td>26%</td>
</tr>
<tr>
<td>Same</td>
<td>49%</td>
<td>46%</td>
</tr>
<tr>
<td>Worse</td>
<td>22%</td>
<td>41%</td>
</tr>
<tr>
<td>Much worse</td>
<td>2%</td>
<td>0%</td>
</tr>
</tbody>
</table>

In Figure 1 we see a near doubling, to 41 percent in 2016 compared to 22 percent in the preceding year, in the number of executives who describe business conditions as worsening. Only 12 percent said they believe conditions are better in 2016 compared to 26 percent in 2015.

**Key takeaways**

Despite near-term obstacles, executives can increase their chances of accelerating growth through:

- Improving the customer experience with digital connectivity solutions
- The introduction of new products created through analysis of data harvested from oceans of information created by consumer’s digital devices
- Creating joint ventures and alliances, primarily with new, insure-tech, industry alliances
- Building in-house venture-capital divisions to incubate new ideas and solutions
- The creation of new distribution channels that mirror those already in the broad marketplace, built primarily by retail organizations.

Insurers who grab the opportunity to become innovators of new products and services by embracing disruptive technologies and transformative forces will be better positioned to reach growth targets.
Risks hindering progress

While risks associated with pricing and underwriting, as well as regulation and market conduct, remain key hindrances, interest-rate risk (see Figure 2) rose 15 percentage points in 2016, compared to the previous year. Low investment returns for the past six or seven years have been an ongoing challenge for an industry that has relied upon healthy returns in fixed-rate investments. But low returns in bonds is expected to persist for the foreseeable future.

As a result of interest-rate risks, many organizations may decide to increase allocations to alternative investments—private equity funds, hedge funds, sovereign wealth funds, and other such investments that not too long ago were generally considered taboo in the insurance industry. At the same time, we expect insurers to tread carefully when considering the possibility of adding hedge fund assets to their investment portfolios, given the recent spike in volatility in that sector.

Figure 2

Most significant industry risks

When asked about the strategies they plan to pursue to address interest-rate risk, 44 percent said alternative investments would remain (as it was in 2015) a key device for managing the risk. And another 18 percent said they would employ other hedge funds in an attempt to blunt the impact of the ultra-low-interest-rate environment in bonds.

Key takeaways

Insurers seeking higher yields through the power of alternative investments may want to consider:

— Focusing on people and transparency – The most important individuals involved in creating strategies involving investments in alternative products are not only those who actually make the investment product choices. Equally as important are the organization’s executives, who must be transparent regarding the reasons why decisions are made, and speak in a language that is clear and concise.

— Clearly articulating reasons why the work will be handled either by in-house talent or why it is necessary to go outside the organization

— Defining all elements that make up the accountability measures imposed on those who manage the alternative investment portfolio

— Informing executive officers and board members – on a regular basis – why certain alternative strategies are being pursued, changed, or discontinued.
Performance expectations and anticipated operating cost environment

Similar to what was mentioned earlier regarding their view of current business conditions, significantly fewer respondents in 2016, compared to the previous year, said they felt their firms would perform better than expected at the start of the year (see Figure 3). There could be a number of factors in play here: Low interest rates, IT difficulties, the unsettled political climate in the United States and other countries, and regulatory uncertainties—just to name a few.

**Figure 3**

_How do you feel your firm will perform in the year ahead?_

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significantly ahead of expectations</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Above expectations</td>
<td>19%</td>
<td>37%</td>
</tr>
<tr>
<td>At expectations</td>
<td>68%</td>
<td>49%</td>
</tr>
<tr>
<td>Below expectations</td>
<td>9%</td>
<td>12%</td>
</tr>
<tr>
<td>Significantly below expectations</td>
<td>2%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Key takeaways

At KPMG, we believe digitization is more than installing IT devices. Instead, digitization requires an organizational commitment to focus on matching tools to a business model that meets customers’ desires. And, in insurance, customers—commercial and retail alike—are seeking efficiency, simplicity, and better digital experiences. As a result, hoards of insure-tech business are biting the ankles of traditional behemoth insurers, slowly but steadily taking away customers and their revenues.

These new, digital businesses essentially are pressuring established insurers to vastly improve their digital capabilities, not only on the front end, but also across the enterprise. In our view, the road ahead is still long. Insurers must leverage emerging technologies on the back end in order to scale their operations, deploy the power of analytics, streamline processes, and offer the type of highly personalized experiences on the front end that customers increasingly say they expect. We urge insurers to further embrace an innovation mindset with digital skills and expertise embedded throughout the organization to drive real transformative change.
Even so, respondents showed optimism when commenting on their anticipation of what will happen to their company’s operating costs over the next year. More respondents this year, as compared to last, said they expect operating costs to decrease instead of increase. (see Figure 4). Though their reasons were not specifically articulated, this result could be due to more businesses embracing digital operational and financial processes in an attempt to cut costs and reduce manual mistakes.

**Figure 4**

What do you anticipate will happen to your company’s operating costs over the next year?

First the bad news …

At the start of 2016, Bank of America/Merrill Lynch published a report on the projected impact on productivity through the use of robotic process administration (RPA), which may be defined as the use of software with artificial intelligence and machine learning capabilities to handle high-volume, repeatable tasks that previously required a human to perform.¹ The report said the global market for robots and artificial intelligence is expected to reach $152.7 billion by 2020, and that the adoption of these technologies could improve productivity by 30 percent.

Steven Hill, the U.S. Head of Innovation and Global Head of Innovation and Investments at KPMG LLP, recently wrote in a CIO magazine article that robotic technologies could affect 230 million knowledge workers before the end of the decade. And, recent research from the London School of Economics suggests return on investment for RPA of between 600 percent and 800 percent for specific tasks.²

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¹ “Target Tech / Internet of Things Agenda,” 2016
With those ideas in mind, we asked the insurance conferees: “Robotics process automation holds many benefits for financial services firms. At what stage is your firm in using RPA?” Their answers – See Figure 5:

**Figure 5**

**At what stage is your firm in using RPA?**

<table>
<thead>
<tr>
<th>Stage Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>I don’t think it’s anywhere</td>
<td>54%</td>
</tr>
<tr>
<td>Discussing/considering</td>
<td>30%</td>
</tr>
<tr>
<td>Piloting</td>
<td>10%</td>
</tr>
<tr>
<td>Integrated into parts of operations</td>
<td>6%</td>
</tr>
<tr>
<td>Integrated into all/most of our operations</td>
<td>0%</td>
</tr>
</tbody>
</table>

Those sobering answers, where only 6 percent said they have integrated RPA into parts of their operations and more than half (54 percent) said “I don’t think it’s anywhere,” may serve as a sounding call to the industry to initiate faster action.
The responses also provoked us to contrast them with our recent cross-industry CEO survey, where we wanted to understand what CEOs were thinking about when it came to disruptive technologies. Their answers are distilled in this graphic:

65% of CEOs believe that the next three years will be more critical for their industry than the previous 50 years.

39% of CEOs feel they will be running significantly transformed companies in the next three years.

“While technology disruption has always been an issue, the difference today is speed.”
– Steve Chase, KPMG U.S. Management Consulting Leader

CEOs concerns
- 81% Keeping up with new technologies
- 76% New entrants are disrupting our business model
- 59% An effective strategy to counter convergence in the market
- 66% Our organization is not disrupting business models in the industry

... Now, the good news

Insurers are answering the call. When considering technology investment, the respondents said their highest priority investment areas for their company over the next two years would be D&A tools to improve forecasting, and cut costs (see Figure 6). What’s more, they expect D&A to help them with better decision-making, as well as a focus on overall improvement on digital capabilities and infrastructure challenges.

Figure 6

IT investment priorities next 2 years

- 41% Forecasting capabilities/data & analytics
- 32% Digital capabilities
- 31% IT infrastructure
The respondents said they would use D&A tools to improve underwriting. In fact, in 2016 the respondents said their reliance on D&A grew by 10 percentage points to 51 percent. At the same time, the use of data and analytics tools to identify customers and their preferences continues to grow, up 4 points in 2016 compared to the previous year to 25 percent.

Further, a significant portion of executives said that key among the activities their business would pursue around innovation over the last 12 months would be cultural change—the willingness to accept change, which will rely heavily on adopting digital solutions to traditional and emerging challenges (see Figure 7). Further, they would boost training related to innovative-idea generation process skills, partner with start-ups or third parties, and develop innovation hubs.

**Figure 7**

What opportunities has your company been pursuing around innovation over the last 12 months?

- Cultural change: 42%
- Training on innovation generation, process skills: 38%
- Partnerships with start-ups or 3rd parties: 36%
- Developing innovation hubs/labs: 32%
Key takeaways

As has been our mantra for several years now, we reiterate the need for speed—but with deliberate planning and execution along with the acceptance of the need for change.

There can be no arguing that the insurance industry is changing ... and, for the better. The change has led to some optimism that sustained growth—at least for some forward-thinking and acting businesses—is more than just a pipe dream.

But, make no mistake. Much, much more work must be done if this industry is to stave off invasion of the ankle biters—who soon may be giants themselves—as well as invasion from some of the enormous digital retailers and data firms that are eyeing insurance as the land of opportunity for growth.

The tech-savvy businesses thrive on speed and agility; two attributes not typically uttered when discussing insurers. At the same time, consumers have served notice: They will not wait for insurers to change. They’ll move on to new entrants or another established insurer if their expectations of highly personalized experience is are not met.

So how fast is fast enough? For insurance executives at our conference, that question loomed large. The stake are enormous. Strategic decisions must be made right now. There also must be quick decisions on how best to manage costs, confront the legacy IT systems challenge, and deal with ever-evolving regulatory demands.

As we saw in the response to one question, a key mandate to be met may center on that oft-squishy topic of culture. No business will change unless there is an acceptance that the good days are just that—old ... and gone. Embracing change and understanding the power of digital processes are essential for change to take root.

The clock is ticking.