The Black Box Institute

Canadian Insurance in post COVID-19 World

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Highlights

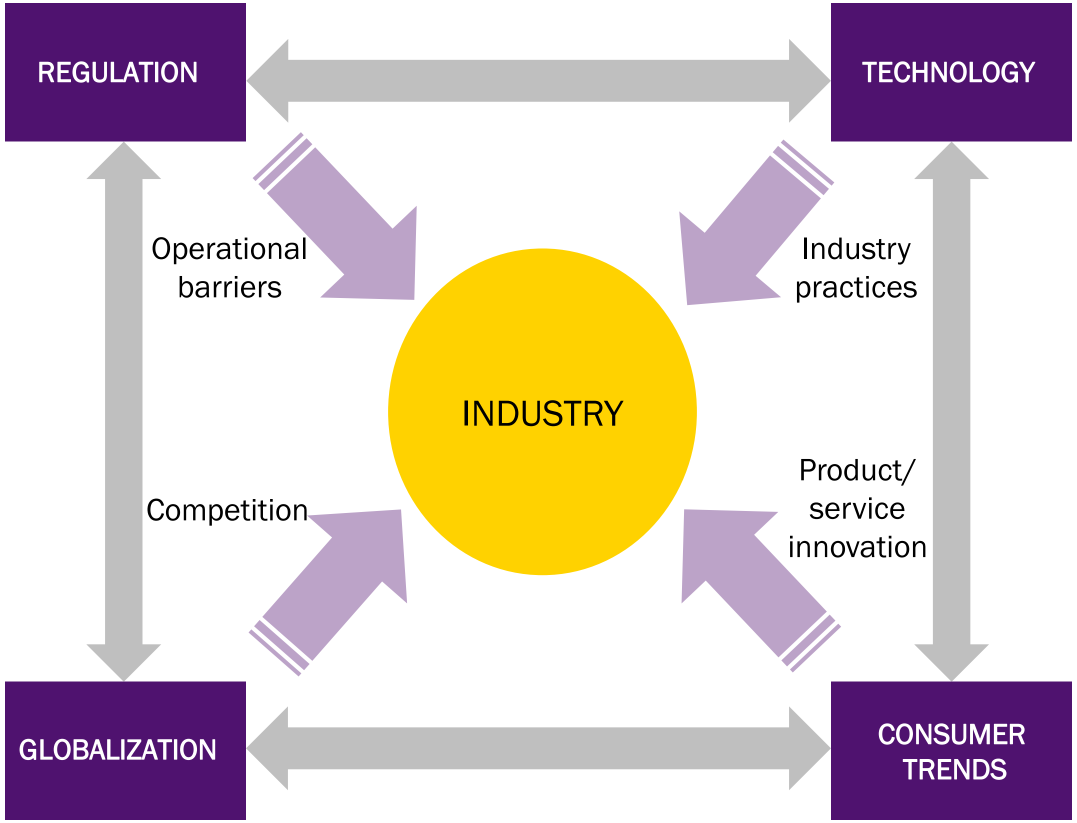
- Technological breakthroughs and digital tools, changes in sociodemographic consumer habits, tighter regulatory environment and globalized economical climate – are making a significant impact on development of the Insurance industry.
- Scenario planning is a tool that helps companies to understand how current and future forces are going to shape the world we will live in tomorrow.
- By plotting multiple scenarios of the future, organizations are able to predict the most likely outcomes of the future while also being ready for the outcomes that do not look as likely at a first glance. The key opportunities are identified while key risks are managed.

The Insurance industry is trying to stay profitable in the face of many uncertainties. If rapid change in technology, globalization, the regulatory environment and sociodemographic forces was not enough, the COVID-19 outbreak has delivered a final message to insurance companies: rapid change is coming.

The COVID-19 pandemic has accelerated some trends while slowing down others. There is no doubt that COVID-19 has potentially changed the direction in which the industry is heading. For example, remote working and remote buying have become more common, while the willingness of consumers to spend their income to try new products may have slowed down. Nonetheless, insurance has been one of the industries most affected by the pandemic, and we will continue to see more trends that demonstrate that thesis.

In this paper, we explore the highly uncertain future for Canadian insurance companies. This includes future market scenarios that consider the short-term market trends (including the consequences of the COVID-19 pandemic), as well as a broader long-term vision of what the insurance industry will potentially look like.

- *More government regulation is expected*. Regulation will continue tightening in the following areas: market conduct, data privacy, fraud detection, capital and risk policy.
- Catastrophic events such as climate disasters, pandemics, economic bubbles and other large-scale crises may drive *nationalization of some of the insurance industry*.

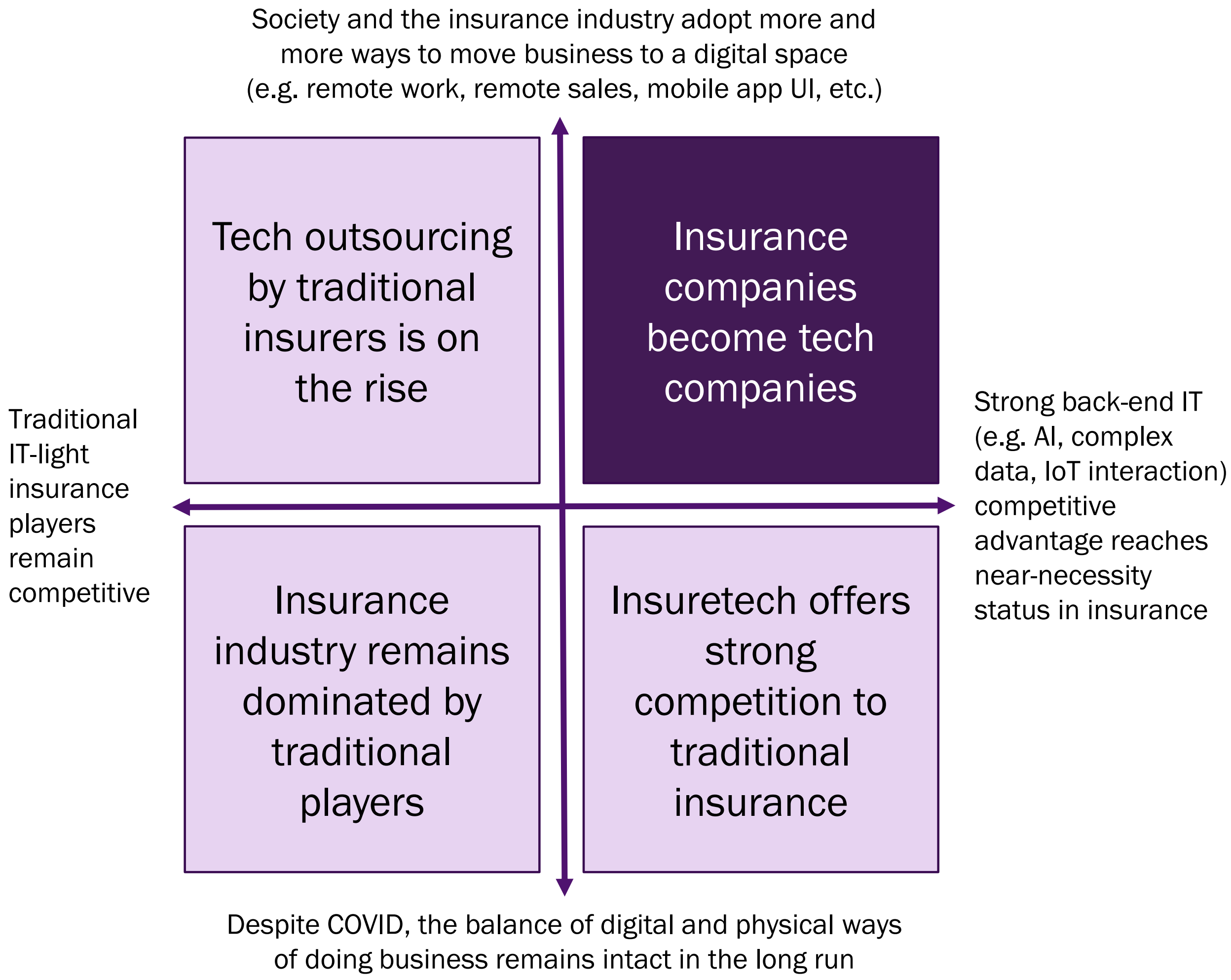


- Insurance companies are adopting *more digital ways of doing business* on both the *customer-end and workplace-end*. 61% of customers surveyed confirm that they prefer to check their applications online.
- The insurance industry is heavily data-driven, so the growth in *AI adoption* and *IoT tracking tools* (e.g. health devices) has a significant impact. The use of data will drive *personalization*.

- Rising *globalization* and *standardization* of insurance practises will make it much easier for foreign players to penetrate the Canadian insurance market, especially with the rise of emerging markets.

- An *aging population* will drive demand for new products but will also increase potential claim volumes in the future.
- *Generation Y demands Innovation*. They want mobility, efficiency, ease of use, and customized experience.

Example of Scenario Set in Insurance



- To develop each set of scenario, we started out with two axes, each with significantly different outcomes at opposing poles. These outcomes were chosen keeping in mind ‘Megatrends’ which will have an effect on the insurance industry in the future.

- The scenarios in the four boxes are deduced from a combination of outcomes on X and Y-axes. So, for example, if one thinks about a scenario that includes right-hand side of X-axis and top of the Y-axis, that might look like the top-right box in darker colour – a scenario where E-commerce booms owing to high adaptability of consumers to online in-store experience and high focus on social distancing norms.

- We considered 3 scenario sets – each equally important for real estate industry. One of them has been shown here as example.

- The value and limitations of this method of scenario planning are that the possibilities of potential axes are infinite, as are the resulting scenarios.

SCENARIO 1:

The Tech-First Organization

Driven by advancements in technologies such as AI, cloud capabilities and IoT, as well as the rising business digitization trend, insurance companies are forced to transform into tech companies

SCENARIO 2:

Free-for-all

More digital, globalized and standardized insurance business practices will push foreign rivals to enter the Canadian insurance market

SCENARIO 3:

Innovate or die

Stricter government regulation in core insurance businesses (life, medical and P&C) will drive companies to diversify into new insurance and non-insurance revenue streams, making innovation a matter of survival

Society and the insurance industry adopt more and more ways to move business to a digital space (e.g. remote work, remote sales, mobile app UI, etc.)

Tech outsourcing by traditional insurers is on the rise	Insurance companies become tech companies
Insurance industry remains dominated by traditional players	Insuretech offers strong competition to traditional insurance

Traditional IT-light insurance players remain competitive

Strong back-end IT (e.g. AI, complex data, IoT interaction) competitive advantage reaches near-necessity status in insurance

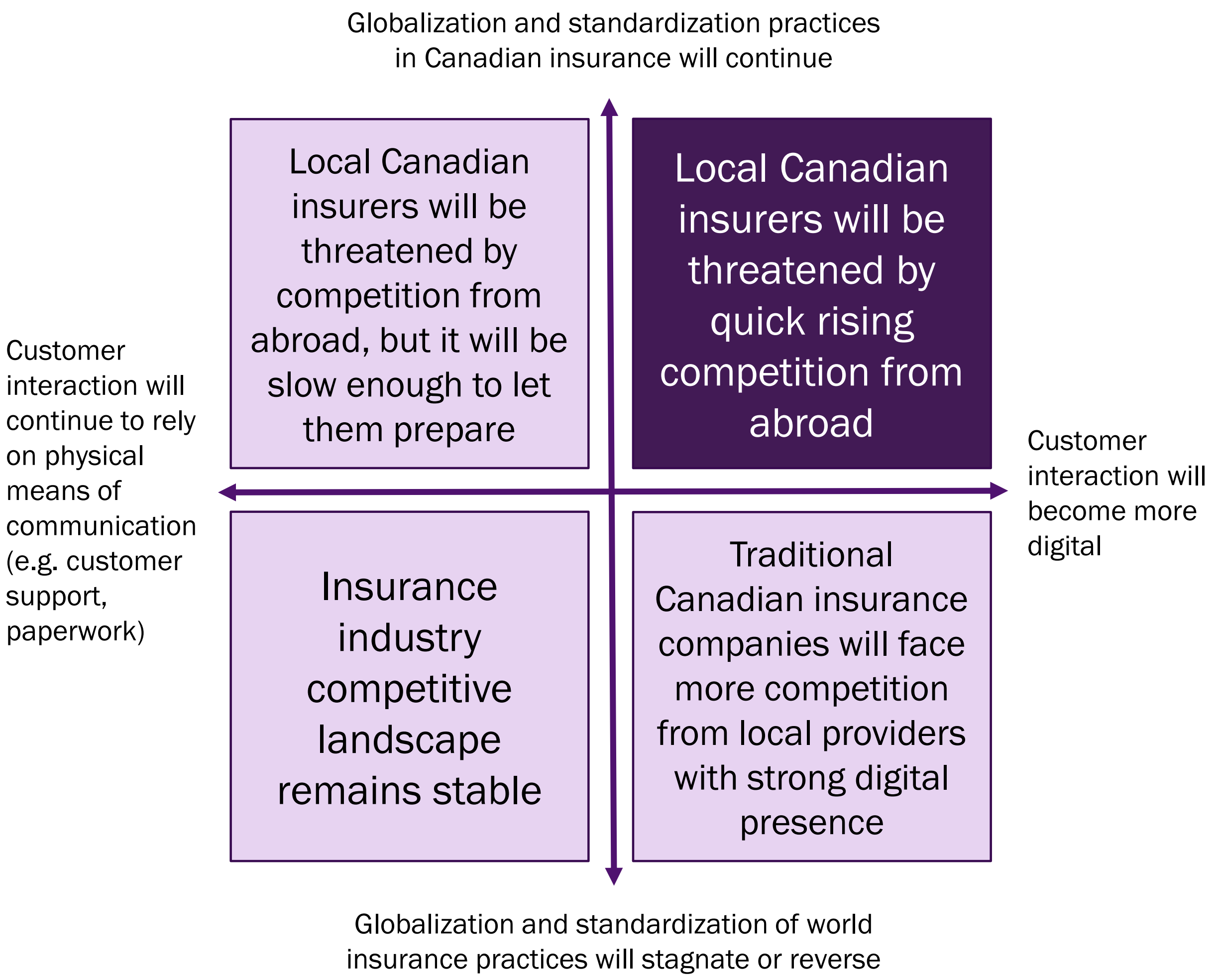
Despite COVID, the balance of digital and physical ways of doing business remains intact in the long run

Changes in the way stakeholders interact with businesses and deep technological advances on the back-end will both push insurance companies to act more like tech companies.

In this scenario, the assumptions are that (1) digitization and remote work will continue to become more common in our society (e.g. branchless banking, video doctor appointments, etc.), and (2) strong IT-infrastructure will become a near-necessity in insurance as tools like AI and Data play important roles in complex financial calculations. Consequentially, existing insurance companies will lean towards adopting strategies for conducting business used by the tech industry and eventually become more similar to tech companies.

Implications

- Primary insurance players' focus will shift towards securing superior software engineering talent, innovation opportunities and rapid growth.
- The recruitment process and company culture will both change to a target a younger, more tech-savvy demographic.
- Not only will insurance players try to become tech, but more and more tech players will try to expand into the insurance space.
- Most of the customer interaction will shift to mobile apps and some IoT devices (e.g. health devices like smart watches). Data will be keptin cloud storage.
- Funding will not be limited to taking deposits, but will also include more VC, crowdfunding and Public Markets.



With the insurance market becoming more globalized, standardized and digitized, Canadian insurance market leaders will face fierce competition from abroad.

With the current trend of society growing more globalized, regulation becoming more standardized and customer service going digital, this scenario case assumes that barriers to entry into Canadian insurance space from abroad will be highly loosened. In turn, it will attract a high amount of potential foreign competitors to existing players, including from regions such as the US, Europe and Asia/Pacific.

Implications

- In order to survive, Canadian insurance players will have to refine their market strategy. Low barriers to entry for competitors will mean that established brand names will no longer be a significant enough advantage for existing leaders. The companies with the most innovative products and service will emerge on top .
- Diversification will become key, for insurers will need to diversify into sectors (e.g. health services) that are not as easily replaced by foreign competition in order to secure their position.
- Existing insurance leaders will not only be forced to compete for customers but also for local talent. As market practises become more standardized across the globe, related skills will be more transferrable, leading to greater demand for Canadian insurance specialists.

Customers will be increasingly receptive to more unique and customized insurance products

High-growth environment: growth in both existing business and new products	Status-quo challenge: more innovative and well-diversified players will come out on top
Status-quo: the industry will keep growing at a stable rate with consistent leaders	Market stagnation: only firms prepared for government cooperation will survive

Government will not significantly tighten regulations post-COVID19

Government will more strictly regulate core existing insurance products (life, P&C, travel, etc.), potentially even nationalizing some

Customers will remain conservative and continue to shop only for existing core insurance products

The insurance industry is heading towards the path of more government involvement, which will put some of the existing insurance businesses at risk. However, there is hope for industry players, and it lies in creating more innovate and unique products.

While the government has already been tightening financial and insurance regulations pre-COVID due to events like the 2008 crisis, this pandemic may further inspire law-makers to increase government participation in the industry. The existing policies are not much of a threat to insurance companies, but post-COVID events are likely to inspire the government to impose more impactful regulations, including capitalization requirements, interest rates, customer profiling, and perhaps even nationalizing some aspects of the business.

While increasing regulation has the potential to stall the insurance market in its current form, insurance companies can keep the ball rolling. With a rapidly changing environment for consumer behaviour and lifestyles, more and more unique insurance products are being received positively. Examples of those products include: AI liability insurance, cybersecurity insurance, pet insurance, device theft insurance, etc.

Implications

- The companies that are focused on innovating their product offering will be the most well-positioned for success.
- Industry players will have to focus on customizing their solution to specific customers in order to stand out. Available technologies ease that process.
- Companies will also have to diversify their offering outside of the Insurance industry to hedge their bets and survive (e.g. offer financial services such as credit cards).

Appendix A: Scenario Planning

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- Scenarios are narratives that describe a potential future world. They are a set of several alternative possibilities formed by drivers of change that provide insight into what could happen.
- To guide organizational strategic thinking about the future, scenario planning is used to develop a shared view of multiple potential paths forward. While it does not try to predict the future with certainty, scenario planning does enable an organization to manage uncertainty by developing proactive and adaptive strategies in preparation for a range of potential futures.
- The scenario planning process has three main steps:

1 Define the Scope

- What is the key question that needs to be analyzed?
- What is the time frame for the analysis?
- Who are the major stakeholders?

2 Explore Trends and Forces

- What trends and forces are driving change externally and internally?
- How much impact will trends and forces have?
- How uncertain is the actualization of the trends and forces?

3 Craft the Scenarios

- What relationships exist between high impact and uncertain forces?
- Are the emerging scenarios plausible?
- Do the scenarios address the key question?

Source: TBBI

Appendix B: Canadian Insurance Industry

Industry Overview

- Insurance is a way of reducing potential financial hardship. It helps to cover the cost of unexpected events such as theft, illness, property damage, or death of a loved one.
- The insurance industry sells insurance policy, a contract which details the conditions and circumstances under which the insurer will compensate the insured. The customer pays a fee called a premium, and in exchange, the insurance company agrees to pay him or her a certain amount of money if the insured event happens during the term of the policy.
- The insurance market in Canada can be divided into three main sectors:
  - **Life insurance** - can provide a financial payment to your family and loved ones upon your death.
  - **Health insurance** - protects the customer from a variety of health and dental costs.
  - **Property and Casualty insurance**– provides property and liability coverage.
  - Other minor types (e.g. debt insurance).

Industry Highlights

Employees
0.3M

Market Size
$130B

Assets held
$950B

Market YoY Growth
Life and Health Insurance: ~5%
Property and Casualty: ~2%

Biggest Canadian Insurance Companies by Assets:

Rank	Company	Assets, $B
1	Canada Life	220
2	Manulife	200
3	Sun Life	173
4	IA Financial Group	58
5	Desjardins Group	40

Value Drivers

Internal

Financial Strength
- Capitalization/Reserves
- Asset Quality
- Risk Strategy
- Asset Diversification
- Ability to Raise Capital

Management Strategy
- Organic and Inorganic Growth
- Operational Efficiency
- Use of Internet and Technology
- Data Strategy: Analytics, AI, Security
- Product/Market Diversification
- Talent Management

External

Socioeconomic
- GDP Growth
- Financial Markets
- Demographic and Social Trends

Government Regulation
- Risk and Capital Requirements
- Reporting
- Fraud Prevention

Source: Financial Consumer Agency of Canada, CLHIA, PolicyAdvisor, IBC, Pefindo, Bizfluent, Deloitte

Life insurance

$21B
market size (premiums)

5.5% YoY growth

Rank	Company	Market Share
1	GreatWest Life	12.6%
2	Manulife Financial	10.3%
3	Sun Life Financial	7.9%
4	IA Financial Group	4.4%
5	RBC Insurance	2.1%

Health insurance

$46B
market size (premiums)

5.2% YoY growth

Rank	Company	Market Share
1	Manulife	N/A
2	Sun life Financial	N/A
3	GreatWest Life	N/A
4	Ontario Blue Cross	N/A
5	Blue Cross Canada	N/A

Property and Casualty Insurance

$58B
market size (premiums)

2.3% YoY growth

Rank	Company	Market Share
1	Intact Group	15.5%
2	Aviva Group	9.7%
3	Desjardins Group	8.2%
4	Co-operators Group	5.6%
5	Lloyd's Underwriters	5.6%

Sources: Lifehealthpro, Mordor Intelligence, IBIS World, IBC, Investopedia

Short-term Trends and Forces – Coronavirus Repercussions

- The insurance industry has been negatively impacted by the turbulence in the markets and economy due to the COVID-19 outbreak more than other industries:
  - The Canadian Life&Health Insurance TSX Index has dropped 33.7% in comparison to a 15.7% drop in the TSX Composite index (YTD as of Apr 16, 2020).
  - Falling interest rates and capital markets directly affect the profitability of insurance and wealth management businesses of insurance companies.
  - Commercial insurance growth may be severely restricted due to a disruption in the business cycle.

- One of the other immediate impacts on insurance companies is the risk incurred by employees' sudden shift to remote working.
  - Some functions, such as claims adjusting, need employee present in the field. Disruptions are expected in the new business and underwriting process due to a dependence on paperwork and in-person underwriting practises (such as for health insurance).
  - Most companies do not yet have the digital tools and platforms to enable those employees to work entirely remotely. Even those who technically can work fully remote may struggle to adjust to this new way of working, especially at first.
  - Remote working tends to inhibit cross-functional collaboration,which is particularly crucial for the claims, underwriting, and actuarial functions.

- Lockdowns around the world forced Insurance providers to establish extensions for renewal processes, which had an immediate effect on premiums.

- Claims are expected to rise in travel, commercial and life insurance. That said, a significant portion of insurance policies have an exemption clause for global pandemics, a practise that became common after the SARS outbreak in 2003. This may lead to public backlash and hurt the industry's reputation overall.

- With all of the above in mind, it is expected that many of the industry players will be forced to go out of business or lose leadership positions in the market during the crisis.

- In order to stay afloat, executives will need to do the following as a part of their emergency response:
  - Accelerate automation and digital transformation. Build remote working models for both the customer(virtual sales and underwriting) and the employee(work from home).
  - Thoroughly communicate with stakeholders.
  - Stress-test and re-evaluate portfolio strategy. Review capitalization, risk profile, etc. Evaluate worst-case scenario.
  - Innovate the product portfolio, including creating new COVID-related products.
  - Work closely with the government to get needed benefits, risk management collaboration, etc.
  - Focus on customer service. Prepare for rising calls, customer claims and subsequent overhead costs to address them.

Source: McKinsey, S&P, Insurance Business Magazine, KPMG, Deloitte

Long-term Trends and Forces

Political

- *More government regulation* is expected. Regulation will continue tightening in the following areas:
    - Data privacy compliance
    - Best interest sales standard
    - Fraud identification and reduction
    - Employee and market conduct
    - Capital and risk management
- Catastrophic events such as climate disasters, pandemics, economic bubbles and other large-scale crises may drive *nationalization of some of the Insurance industry*. It could be a challenge for insurance players as the government can take away some of their business, but also presents an opportunity to supplement their business and eventually strengthen the industry (e.g. governments may set up funds that mitigate consequences of insurance mass insolvency crises).

Environmental

- *Climate change* creates a whole range of new risks for businesses that will be in some form managed by commercial insurance companies, including:
    - Risk of physical damage to the business due to natural disasters.
    - Financial risk associated with the climate-related turbulence in the market.
    - Transition risk for companies incurring extra costs to adapt to new regulatory requirements.
- On the other hand, a *new range of environmental risks such as* pandemics and climate is an opportunity that drives a demand to create *new insurance products*.

Social

- *Globalization* and standardization of insurance practises will make it much easier for foreign players to enter the Canadian insurance market, especially with the rise of emerging markets.
- *Aging population* - As baby boomers start to retire, they take money out of their accumulation products to provide an ongoing source of income; trillions of dollars will flow out of these products over the next 5 to 10 years. However, as those people live longer than past generations and have wealth, they continue to generate *demand for new products*, e.g. long-term care insurance.
- *Generation Y demands Innovation*. This generation is highly unlikely to buy insurance through a broker. They want mobility, efficiency, customized experience, and ease of use.
- Change in demographics will also create *talent crisis in insurance*. Younger candidates have little desire to venture into insurance over other, more 'exciting' industries. This is where more innovative firms such as insuretechs will stand out by appearing more dynamic, connected, and disruptive.

Technological

- Insurance companies are adopting *more digital ways of doing day-to-day business*. Increased technology adoption and availability of new tools have enabled more remote operations on both the front-end (*customer interaction*) and the back-end (*remote workplace*). According to a survey, 61% of customers prefer to check their applications online. This change will be exaggerated by the COVID-19 pandemic moving forward.
- *Insuretechs* have received significant attention recently. Insurers are looking to collaborate with the right technology innovators to improve and grow their business, including in relation to distribution. Insuretechs in Canada so far include include Zensurance, Lemonade, Metromile, and others. In the UK, Google has already entered an insurance space.
- The use of data will drive *personalization*. By activating and collecting the right data – from IoTs such as connected cars, activity trackers, health, etc – insurance companies are able to better understand consumer needs and offer more customized products, coverage and advice.
- AI and machine learning have the potential to impact every process in insurance, making them more efficient. Various functions such as fraud prevention, anti-money laundering, underwriting, and pricing are set to be overhauled using this revolutionary technology.
- With the increased use of data, *cybersecurity and privacy* will play a major role for insurers.

Economic

- *A falling interest rate environment* has put industry profitability in jeopardy. As an industry that does not have high margins to begin with (ranges in between 3 and 10%),it is highly sensitive to a drop in investment returns, as insurance companies use invested money to pay out claims.
- *Capital markets volatility* also has negative implications for the solvency and profitability of insurance companies.
- Some expectation of *increased M&A activity* in Canada is supported by a general increase in the level of insurance M&A activity in the US, as well as a number of underlying trends, including: organic growth challenges; emerging strategies to apply scale increasing internet distribution; evolving consumer demands; historic levels of excess capital; and increased North American interest in insurance M&A from strategic players and private equity. Although M&A activity might stall during the COVID-19 crisis, it will likely re-launch when the crisis is resolved.

Source: Deloitte, Insurance Business Magazine, DXC-technology, Board of Innovation, Chambers and Partners

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