Pulse Check – State of the European Insurance Industry

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Survey Report

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EDITOR'S REMARKS

We are delighted to present the third edition of the annual ISG Pulse Check – State of the European Insurance Industry report.

The Pulse Check report aims to deliver a comprehensive picture of the European insurance industry. We have combined the results of a November 2022 survey of 200 insurance company and technology ecosystem executives across Europe with insights from our industry research and our experience as a leading global technology research and advisory firm guiding clients through complex transformation programs.

We are confident the resulting report will add important context as you identify and pursue your organization's strategic priorities and digital initiatives.

EXECUTIVE SUMMARY

The European insurance sector has weathered significant challenges and changes in recent years. The industry will again be tested in 2023 and 2024, but in different ways.

- European insurers continue to pursue strategic initiatives, such as creating new opportunities for millennial buyers, managing competition with InsurTechs and driving organizational agility. We observe the emergence of new themes such as strengthening operational resilience, ESG performance and evolving business models – like embedded insurance – gaining in importance, as more InsurTech companies become an integral part of the industry.
- Economic sanctions against Russia and the Ukraine conflict have only had a limited direct impact on European insurers, as insurers' assets and underwriting risks were modestly exposed to these territories. However, when asked how much the current macroeconomic situation impacts the business, broader geopolitical frictions, which go beyond this war, were highlighted most clearly.
- The results show that inflation and fears of recession could be growth impediments for the insurance markets. Inflation, awakened by disrupted supply chains during the pandemic, has reached new record highs month after month and is becoming a severe issue as fears of a global recession become more real. Higher claims are challenging the profitability of the non-life insurance business, and insurers will try to compensate with premium increases and by optimizing operating costs. Inflationary pressures require higher interest rates, which can lead to liquidity problems for insurers when cancellations increase due to premium price hikes. Greater volatility in financial markets and tensions in cyberspace add to existing concerns.
- Insurance enterprises strive to balance necessary technology investments and reduce physical distribution costs to improve profitability. Interviewed stakeholders indicated they will focus on their core competencies and cost structure to improve growth and profitability, redesign and reshape their operating model, embrace an agile approach, and address the future skill and competence mix.
- Rationalization and simplification of the application and infrastructure landscape, vendor consolidation, cloud, cognitive analytics, cybersecurity and AI will be top priorities for technology investments in 2023. Insurance companies have tended to linger with custom-built legacy ecosystems, but things are changing. Insurance is fast catching up with other sectors on technology adoption – not just in the front office, but across the value chain.
- Four out of five insurers have plans to take advantage of the emerging world of Meta and Web 3.0. However, the scale of this investment is expected to remain small in the next few years.

Anna Medkouri
Partner, EMEA Lead Insurance

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GLOBAL GEOPOLITICAL ISSUES, INFLATION AND FEARS OF RECESSIONS PREVAIL AMONG INSURANCE COMPANIES

Global political and economic conditions are impacting almost every economic sector. The insurance sector in Europe is no exception. Three macro-economic factors are driving the leadership agenda:

- Geopolitical frictions
- Rising inflation
- Impending fears of recession

Initial indicators suggest EMEA insurers have maintained their resilience against geopolitical turmoil. Most European insurers and reinsurers have substantial capital relative to their ratings. Still, a sustained downturn in financial markets would erode their capital headroom and could put pressure on some ratings in the medium term.

In the Eurozone in Q2 2022, household income increased by 1.0 percent in nominal terms. The prevailing inflationary conditions in the EU drove the household savings rate down in Q2 2022 (12.6 percent Q2 2022 vs 14.6 percent in Q1 2022). This drop has impacted the spending on insurance products across Europe.

Most survey respondents indicate greater chances of an impending recession over the next two years. Recessionary conditions may further tighten insurance spending as B2B and B2C clients revisit their risk mitigation plans. These sentiments echo a Europe-wide challenge for businesses across various industries and segments.

ISG notes that the risk of loss for insurance companies due to general geopolitical tensions is -$ 2 billion, and total exposure is -$ 36 billion – the negative sentiment is spreading in the global economy. Further aggravation from disrupted supply chains and the energy crisis also may affect the insurance markets as inflation and probable recessionary conditions are residual risks in the market.

In addition to the ongoing pandemic recovery and rising geopolitical tensions, the climate crisis continues to pose a significant risk. Extreme weather catastrophes such as tropical cyclones, forest fires and floods, less than half of which are insured, could lead to a further sharp increase in natural hazard losses. Munich Re puts losses from floods in western and central Europe alone at -$ 46 billion in July of 2021 and storms in northwest and north-central Europe at -$ 5.2 billion in February 2022. The summer of 2022 also saw an increase in natural disasters, and many European regions experienced devastating forest fires, extreme heat waves, unprecedented droughts and destructive floods. The damage can often not be precisely quantified, as secondary effects, such as heat-related production losses in the industry due to a lack of cooling water during the drought, are only determined later. At this stage, it can only be stated that these record levels could rise again in the coming years.

Percentage of respondents who rate these issues as having significant or notable impact

76%
Impact of geo-political frictions

74%
Impact of recession on insurance

70%
Impact of inflation on insurance

TOPLINE GROWTH IS EXPECTED TO BE A KEY PRIORITY FOR EUROPEAN INSURERS

Most large European insurers posted a positive financial performance in the first half of 2022. However, our survey reveals that many insurers are concerned about their ability to retain this topline performance in 2023–25.

The European insurance industry will be working hard to balance investments between maintaining profitability and driving premium growth. Insurers will have to reprioritize their strategic agenda as increasing customer churn rates may dampen revenue performance.

94 percent of the survey respondents said winning new customers will be a top priority in the next two years. Additionally, 78 percent of respondents said they prioritize retaining existing customers for sustained performance. Insurance companies are investing aggressively in developing digitally focused business models to create opportunities for growth. In this pursuit, insurers turn to technology solutions and partnerships in the technology sector to help achieve this goal.

ISG anticipates this trend will continue for the next four quarters. Our clients have indicated a strong affinity for investing in customer-facing technology that aligns with business outcomes. While adding to the client base is a top priority, insurers often face challenges in embracing digital advantages due to their legacy infrastructure and limiting vision.

ISG regularly advises insurance clients to establish a clear mandate on return on efforts and expected business outcomes when working with service providers on these strategic initiatives.

Percentage of respondents who rate these priorities urgent

INSURERS WORK ON OFFERING INSURANCE OPTIONS AND BETTER PRICING TO CUSTOMERS

Most insurance buyers are likely to seek options for cheaper products that cover the essentials they would expect from their insurance policies. The trend around price sensitivity and shedding any non-discretionary spending on insurance may require insurance companies to rethink their pricing policies and product offerings.

A significant amount of discussion has been stimulated across the sector to identify ways to reduce the cost of insurance through better underwriting, hyper-personalized risk assessment and policy development. Insurers are realigning their operating models to cater to changing customer expectations.

For example, insurance companies previously spent more on traditional marketing methods and infrastructure, which has resulted in higher operating expenses. The advent of digital marketing has significantly reduced these costs, allowing insurance companies to pass those benefits on to their customers through cheaper premiums.

For insurers, inflation will increase claims costs. This will be more evident in non-life than life insurance, where policy benefits are defined at policy commencement. Motor and liability insurance segments will likely be most immediately impacted.

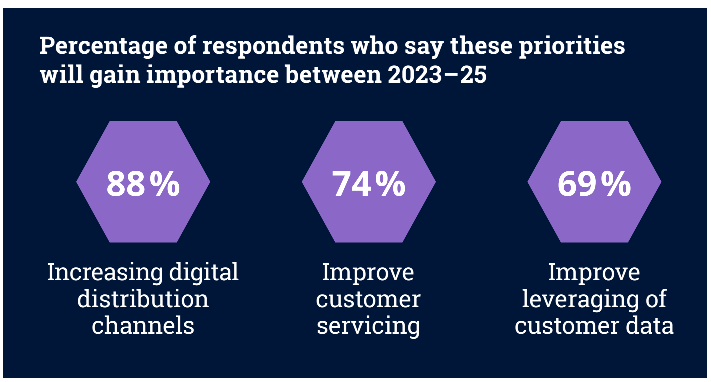
COST OPTIMIZATION WILL CONTINUE TO BE THE FOCUS IN 2023

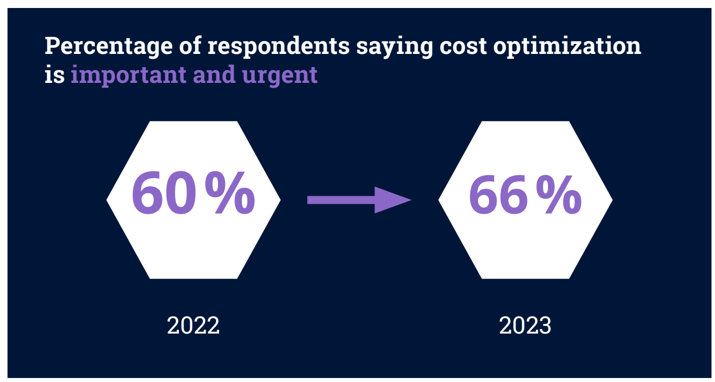
Operating costs for European insurers are likely to increase in 2022–23. In addition, rising inflation in Europe, which jumped to 8.9 percent in July 2022, the highest in 25 years, is expected to hurt the profitability of property/casualty insurers in 2022–24. General (or P/C) insurance claim payouts in Europe may grow by 5.1 percent in 2022. In contrast, premiums will grow at a lower rate of 4.9 percent, further indicating a negative impact on insurers' profitability.

The headwinds of downward pressure on bottom-line performance will drive large and small insurers to aggressively prioritize cost optimization. ISG expects cost optimization will be developed and executed across the organization in various formats.

From marketing strategies to technology adoption, intense discussions are brewing in the boardrooms of many clients. Some immediate considerations indicate insurers are looking at a 360-degree view of cost optimization, exhibiting a more mature and evolved viewpoint on such initiatives.

- **Saving costs through digitalizing marketing efforts:** Insurers seek to find cost savings in alternatives to current high-cost activities such as marketing or customer service, and to pass the savings to their customers. Many insurers are turning to personalized yet low-cost digital platforms to improve their market reach and visibility.





- **Replace legacy systems to support future growth:** Traditionally, insurers have maintained a rich legacy technology ecosystem. Cutting costs and simplifying existing infrastructure is a priority for European insurers, and many are decommissioning legacy systems, rationalizing application portfolios, and heavily streamlining their products. Migrating workloads and systems to cloud-based solutions and digital platforms is almost a commonplace discussion.

67% of respondents highlighted the urgency of replacing their legacy systems to be future ready

- **Vendor consolidation:** We explicitly investigated the affinity of insurers towards vendor consolidation – especially in the technology domain. Almost six out of 10 respondents highlighted their desire to increase their already active vendor consolidation efforts in the next two years.

59% of respondents are actively pursuing vendor consolidation activities for effective performance

- **Outsource more business operations:** 74 percent of respondents indicated a solid need to outsource their business processes. In the past few years, ISG has witnessed remarkable growth in "platform based" BPO solutions and services.

74% of respondents indicated they would increase outsourcing to add value and lower costs

ISG believes insurers are long overdue for value-based investments. Many insurers need help upgrading their legacy technology ecosystem, which prevents them from competing effectively with disruptors and born-in-the-cloud insurance providers. The next three years will be critical for insurance companies as more technology penetrates the value chain and customers expect digitally evolved experiences.

INSURERS TURN TO DIRECT INSURANCE CHANNELS FOR LONG-TERM GROWTH

Disintermediation – the replacement of a classic intermediary with a digital marketplace – is an ongoing trend in the insurance industry. More than 75 percent of respondents state that developing direct channels is an important or urgent priority in the next two years. According to industry analysts, direct insurers benefit from lower sales and sales-support costs, with cost ratios more than 70 percent lower for the median direct insurer than the median multichannel insurer.

Studies have established that larger-scale direct insurers tend to have a high total acquisition cost advantage of more than 50 percent compared with other direct or multichannel insurers, and the issuance costs are 30 percent lower than multichannel operators.

Traditional sales channels may be preserved in life insurance, but the call to action in other segments is clear. Intelligent technology has absorbed the broker's work to tailor a personalized product to a customer. In addition to the obvious cost benefit, it is generally much more appealing, offers a shorter lead time to close and is a more streamlined process due to less friction. Insurers believe that a direct insurance business model could help organizations build better, seamless customer experience propositions and help them improve their market reach through geographic expansion.

ISG believes delivering on direct insurance will need a more holistic approach than simply building customer-facing applications. A great direct insurance business will combine a superior front end with a fully automated middle and back office. Insurers may have to reassess the digitalization of their entire value chain to deliver sustainable customer experiences over the years to come.

More digital investments in direct insurance to come

56%

of respondents reported less than 20% of revenues come from direct insurance channels

67%

of respondents highlighted the urgency to focus on this channel in the next two years

OPERATIONAL TECHNOLOGY UPGRADES WILL DRIVE THE TECHNOLOGY INVESTMENT AGENDA

Most insurance companies embrace intelligent automation to drive operational efficiencies and better customer experiences. Platform-based intelligent automation tools that combine several cognitive functionalities, like intelligent document processing for claim filing regulatory compliance in no-touch mode, and contact centers equipped with high-end NLU/NLP conversational AI engines, are serving as entry points for omnichannel customer interaction.

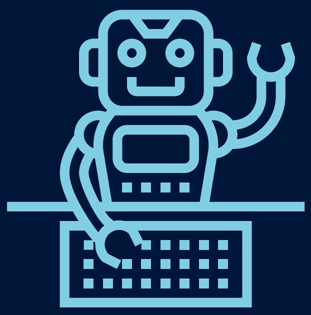
Special attention should be paid to the growth of process mining platforms, not just for RPA automation opportunities but for building and controlling the application with a business intelligence layer.

To create a seamless organization, European insurer AON is leveraging IBM's robotic process automation solutions for back-office business processes such as underwriting. In addition, they bolstered their regulatory compliance process through an AI-led content management feature. As a result, the insurer was able to reduce the workload of 1,600 employees.

ISG believes that reducing agents' daily time-consuming activities can free up the agents for strategic activities like winning new customers. The survey echoes ISG's viewpoint that more than half of respondents are considering immediate investment in automating business processes. ISG believes the urgency of automation investments will escalate between 2024–25. Insurers will likely find it challenging to identify the right talent sources to execute internal automation efforts. This presents a unique opportunity for providers who understand the domain well and can offer technical expertise on automation.

95%

of respondents have indicated that they would term automating business processes 'urgent and important' for their business for the next two years



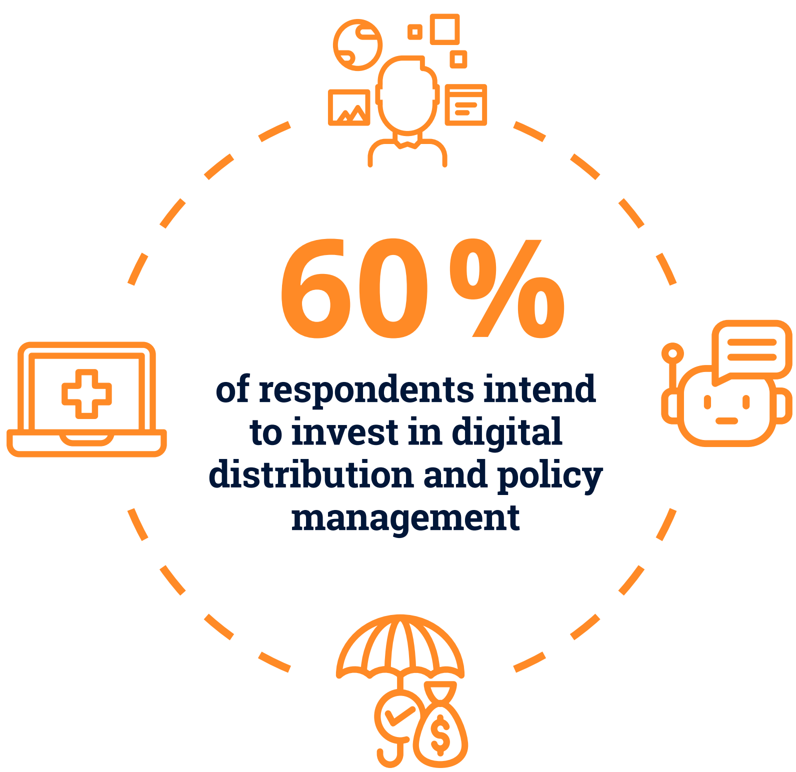
Empowering digital distribution channels

The survey highlights that more than 60 percent of European insurers will seriously consider increasing digital distribution channels as a high-priority investment initiative between 2023–25.

Digital channels have enabled insurance customers to efficiently buy or renew insurance products, file virtual claims, and seek on-demand consultations with their agents. Moreover, insurers are simplifying the insurance management process by integrating advanced technologies into distribution platforms, such as self-service tools and chatbots, and offering a much smoother customer experience.

For example, Zurich UK has partnered with CoreLogic to digitize its claim process on a secure real-time web application. Reduced claim lifecycles, cost optimization, enhanced accuracy and transparency in the claims management process are some of the benefits Zurich realized through this digital distribution channel.

Similarly, Chubb has been taking advantage of cross-sector opportunities across insurance, retail, e-commerce and other industries through Chubb Studio, a digital platform. This platform allows non-insurance businesses to include Chubb's insurance products in their online website and offers customers a wide range of insurance products and services.



IT outsourcing in the European insurance sector is expected to stay buoyant

The Q2 2022 ISG Index™ reported 31 percent growth in IT outsourcing, which splits into 35 percent growth in managed services and 26 percent growth in the as-a-service segment, with insurance (and banking/financial services) the fastest-growing industry for outsourcing services. With pressure on cost optimization and the difficulty of accessing talent, insurers may intensify their search for suitable outsourcing support as a response to challenges.

BPO/ITO convergence

Through new technology offerings, such as intelligent automation, ITO and BPO are being interlaced, which motivates providers to offer them jointly instead of as singular ITO or BPO offerings. ISG sees these joint offerings resonating well in the market and helping providers controlling technology, software and workforces realize the efficiencies that have been the base for their competitive bids.

Mainframe-to-cloud

Clients expect commercial and delivery flexibility in contracts, including transitioning from mainframe/legacy apps to new ones in the cloud. Those should not result in penalties to terminate or switch from mainframe/legacy services to the cloud if they all stay with the same provider. If those transformations are offered as “no cost transformations” without upfront fees but benefit realization during the contract, it gives the provider an additional strong argument.

Build vs buy for “in-point solutions” – InsurTechs join the party

The majority of survey respondents said the need to cooperate with Insur- and FinTechs is urgent, and more than 50 percent said it is also important, with this increasing in the years to come. Only one response considered the need to cooperate as not urgent, and not important.

This is also reflected in ISG research and market observations, including:

- Corporate and specialty insurer HDI Global and digital insurer Neodigital starting the joint venture underwriting agent “Hector Digital” for motor fleet insurance and management.
- Swiss start-up Kasko2go gets advisory support and insurance coverage from Munich Re for its “KI based” mobility solutions.
- Global claims services provider Sedgwick using software from B2B InsurTech Claimsforce to optimize handling and settling claims that require field services.
- Allianz X takes over late-stage InsurTech Simplesurance, a provider for embedded insurance solutions, invests in U.S. underwriting agent Pie Insurance and acquires U.K.-based Innovation Group, a global provider of claims and technology solutions.
- Tive, a provider of real-time supply chain visibility insights based in Boston, gets investments from AXA Venture Partners.

However, conditions for InsurTechs became difficult in 2022 due to inflation, rising interest rates and capital costs. After investors poured large sums of money into the young companies when interest rates were low, the increase in interest rates put pressure on InsurTech and fintech ratings because investors now have alternative investment opportunities.

As a result, the InsurTech sector has been the subject of insolvencies and other negative headlines:

- Blockchain initiative B3i, IT service provider Digital Insurance Group and comparison portal Joonko had to file for insolvency due to lack of investment.
- U.S. InsurTech pioneer Lemonade, with a market presence in France, Netherlands, Germany and – since October – also in the U.K., has lost 80 percent of its value since going public in July 2020, although the outlook for Lemonade’s future business has hardly worsened.

However, this also creates opportunities for investors to buy more InsurTech for the same price. Recently it was pointed out that even the 2022 volume of German investment in InsurTechs of € 700 million represents only 0,03 percent of the premium volume in this region, indicating room for investment, co-operation and competition to continue to develop.

Sustainability and ESG are top five priorities

The sustainability agenda assumed a place as a top five priority for insurance companies for 2023–25. European insurers are pursuing ESG strategies and mobilizing technology investments and strategic alliances to minimize the impact of climate change, enhance their reputation and increase their shareholder value. The recent example of Munich Re, Hannover Re, SCOR, Swiss Re, AXA and Zurich publicly committing not to underwrite the controversial East African Crude Oil Pipeline (EACOP) highlights the focus on their ESG efforts.

In another example, insurers collaborate with technology providers to implement data solutions to help them identify ESG-related risks and build more sustainable solutions:

- ESG Book, a global leader in sustainability data and technology, secured an additional $ 35 million in Series B funding in partnership with Energy Impact Partners (EIP), Meridian and Allianz X. The funding is used to build tech-enabled ESG data solutions and help insurance clients address their sustainability requirements.
- AXA's investment management arm, AXA IM, recently announced the launch of a new Natural Capital strategy, broadening its portfolio of nature-based solutions. With € 500 million in commitments, this strategy will finance projects that protect natural habitats from deforestation and will be quantified through the issuance of voluntary carbon credits.

Top priorities for insurers between 2022–25: Sustainability enters the top five priority areas

1. Win new customers
2. Improve customer retention
3. Improve customer pricing
4. Develop businesses for the digital age
5. Improve sustainability

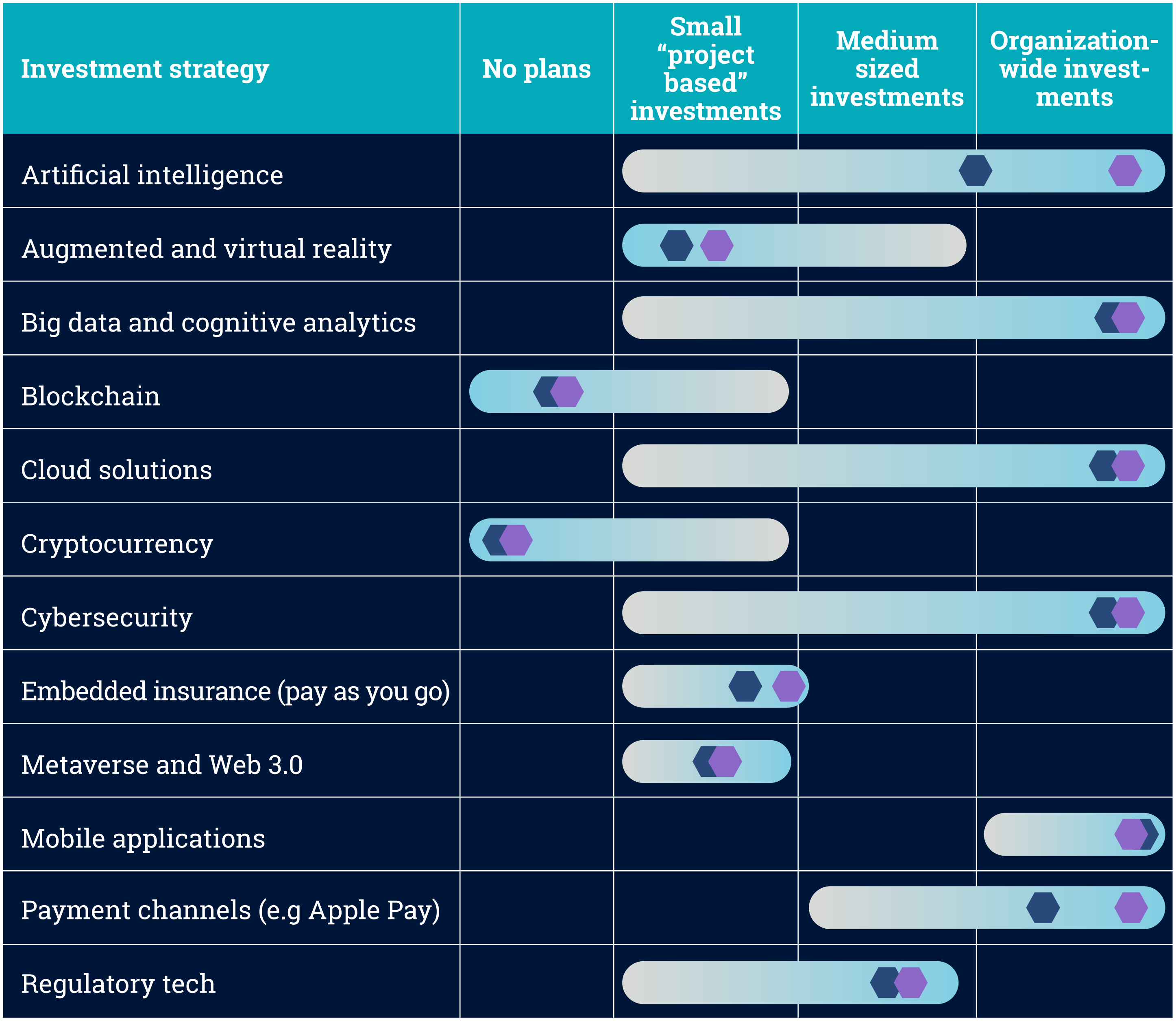
Improving financial performance or embracing stability during a recession (1–3)

Staying relevant to the market (4)

Emerging priority among leaders (5)

INVESTMENT STRATEGY LANDSCAPE – 2022–25

Survey respondents identified the following investment priorities:



Current focus of investments

Majority

Feedback on what current investments look like

Expected shift in investment by 2025

WHERE ARE CRYPTO, METAVERSE AND WEB 3.0 HEADING?

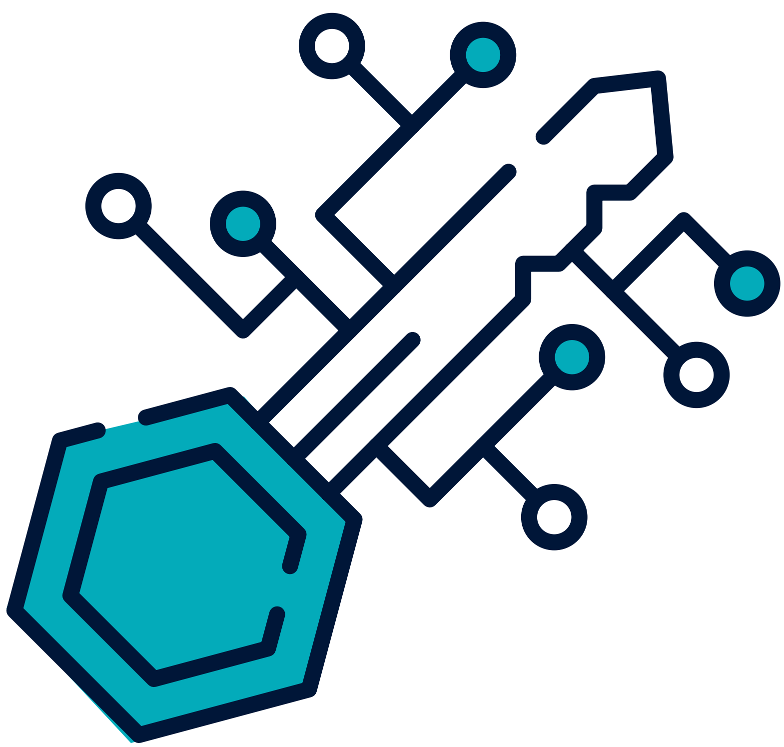
Insurers are treading cautiously with Metaverse and Web 3.0. While every insurer is keen to understand the benefits and working models of their digital twins, the role of crypto, Metaverse and Web3 are still in the experimental phase.

Traditional insurance businesses, like many others, are trailblazing a path, evidenced by the fact that just a few insurance companies plan organization-wide investments in the Metaverse domain. However, the business opportunities for insurance on these platforms are expanding, and insurers are not deterred by the threat of cybercrime from exploring the potential business leverage they can gain from these tech formats.

Currently, most insurers are looking at these platforms as potential emerging client industries. Like physical assets, highly valorized NFTs can be stolen or hijacked. NFT or Coin market-places may request liability protections. Our survey revealed that most insurance companies feel it is too early to discuss concrete operating models and business opportunities the Metaverse may offer.

Interestingly, many insurance companies tend to believe the business opportunity is much more significant than what insurers can envision today. Hence, insurance companies are experimenting with small investment projects in the Metaverse to stay ahead in their games.

ISG believes it will take at least 18 months to see an organization-wide rollout of an industry-specific use case for Metaverse. Of course, industry-agnostic use cases like hiring and onboarding are typical applications to which insurers will adapt faster.



CONCLUSION

In 2023, insurers that want to remain relevant must make customer centricity a top priority and focus on attracting new customers, improving customer retention and pricing, and developing businesses for the digital age. The survey also identified improving operational performance a topic of growing importance, with sustainability as a new entry in the top five topic areas.

All this is embedded in a macroeconomic environment in which insurers need to find solutions to counter the pressure on profit margins and push through premium increases to cover rising operating, capital and claims payment costs.

In addition to the increased complexity of changing customer needs and the growing demand for personalized solutions, the agility to respond to unforeseen developments such as the return of inflation and massive geopolitical risks, as well as streamlined business processes and use of technology to enable this agility, are driving forces for this sector.

ABOUT THE ISG INSURANCE PRACTICE

Our expertise for your business, operations and technology transformation

The ISG insurance practice specializes in business-technology strategies, partner-ecosystem advisory, cost optimization, IT modernization, digital and cloud transformations. We work with Life and Annuity (L&A), Property and Casualty (P&C), Health and Reinsurance companies in the private and public sector.
Our advisors cover quote to claim. We advise in new business, underwriting and claims management, as well as policy administration that includes provider and platform selections. We help insurers review and redesign operating models, insourcing, outsourcing and rightshoring of IT and business processes (ITO & BPO), vendor consolidation, application & infrastructure rationalization, and future workplace.

Strategize and execute your partner ecosystem roadmap

ISG is a global and European leader in providing partner-ecosystem advisory and benchmarking services to guide our clients to successfully bid, negotiate or renegotiate contracts. With the emergence of digital technologies, we created our robust sourcing methodology for private and public tenders to help you achieve appropriate vendor/provider relationships to address newer business and IT models, such as Agile, DevOps and AI. Plus, our tools can help you manage your ongoing third-party relationships and risks and serve as a solution accelerator for all transformational roadmaps.

ISG maintains up-to-date information about emerging technologies from diverse sources, including directly from top business process and technology service providers, third-party administrators, InsurTech and platform suppliers. This enables us to provide deep, unbiased insights about the provider ecosystem for automations, transformations and traditional models.

We are prepared to invest in the success of our clients. With ISG, you can identify the root causes of cost, productivity and service quality issues, and design a roadmap to achieve excellence and sustainable results.

For more information, please visit our website:
Insurance | ISG (isg-one.com)
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As an ISG Partner and EMEA Lead Insurance, Anna Medkouri is responsible for ISG's insurance business in Europe, the Middle East and Africa. Her work focuses on digital and IT strategy, IT portfolio management, application strategy and transformation, cloud adoption, development of target operating models and optimal partner ecosystems. Her more than 25 years of experience helps clients avoid mistakes and apply best practices. With energy, perseverance and prudence, she reliably accompanies clients every step of the way and ensures that every project is a success.

Joachim Ullerich, Director

Joachim Ullerich is a director in the ISG EMEA insurance practice, where he is responsible for business development and relationship management with clients in this sector. Based on his deep understanding and experience in the insurance industry, he focuses on IT-enabled business transformation, which includes the conception and implementation of complex application systems, project management for transformation and migration projects as well as the development of target operating models with special consideration of sourcing options for internal and external partners both locally and globally.

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Florian Scheibmayr, Principal Analyst

Florian Scheibmayr is a distinguished principal analyst and assistant director for ISG Research. He covers intelligent automation, the client experience and selected applications domains, and performs market sizing and go-to-market studies for clients in the EMEA region.

Bharti Nagraj, Research Specialist

Bharti has been with ISG Research for six years. She curates the firm's insights into presentations, white papers, survey projects and custom research engagements for insurance industry clients.

ABOUT ISG

ISG (Information Services Group) (Nasdaq: III) is a leading global technology research and advisory firm. A trusted business partner to more than 800 clients, including more than 75 of the world's top 100 enterprises, ISG is committed to helping corporations, public sector organizations, and service and technology providers achieve operational excellence and faster growth. The firm specializes in digital transformation services, including automation, cloud and data analytics; sourcing advisory; managed governance and risk services; network carrier services; strategy and operations design; change management; market intelligence and technology research and analysis. Founded in 2006, and based in Stamford, Conn., ISG employs more than 1,300 digital-ready professionals operating in more than 20 countries—a global team known for its innovative thinking, market influence, deep industry and technology expertise, and world-class research and analytical capabilities based on the industry's most comprehensive marketplace data

For more information, visit **www.isg-one.com**

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