KPMG

INSURANCE

Globalizing the Risk Business

Surviving and competing in the global insurance industry

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Preface

KPMG International commissioned the Economist Intelligence Unit (EIU) to produce this report, which explores how insurers and re-insurers can adapt their business models in response to global competition and increased consolidation. The report is based on the following research activities:

- The EIU conducted a global survey of 148 senior executives in the insurance and re-insurance industry.

- To supplement the survey results, the EIU conducted in-depth interviews with senior executives from a number of leading insurers.

Executive summary

Insurers and re-insurers looking for a quiet life are likely to be disappointed. Far from slowing down, the pace of change within their businesses worldwide is likely to speed up over the next few years. The result could be a further step towards globalization and yet more consolidation within the industry.

A global survey of 148 senior executives, conducted exclusively for this report, suggests that those firms who get closest to their customers are likely to come out on top and that the biggest firms within the industry could get bigger still. Half of the respondents said that the pace of consolidation is set to accelerate, while 45 percent say that their firm will take part in a merger or acquisition over the next three years.

These forces may cause insurance companies to rethink their business models in a number of areas. They should identify and build on their strengths, and consider exiting from those areas of the value chain where they are weak. This report sheds light on where and why insurers should adapt their business models over the coming years. The research points to several areas that insurance companies should focus on as they work to streamline and globalize their business operations:

Global restructuring. Insurance markets in the U.S. and continental Europe are still highly fragmented, providing abundant opportunities for further restructuring. As noted, half of the executives expect consolidation in the global insurance industry to accelerate. At the same time, insurance companies are exiting from non-core business: for example, around three-quarters of survey respondents say that their company had either left a national market during the past three years by selling its operations there or by closing down an office.

Customer focus. The single most important lever of competitive advantage is quality of service, according to 70 percent of executives in the survey. The theme of customer focus is reflected elsewhere, with insurers working hard to create powerful global brands on the one hand and to deliver products that are tailored to the needs of specific customer groups on the other.

The role of technology. The need to improve customer responsiveness while reducing costs may also require many insurers to update their IT systems. In many insurance companies, data is locked within different silos around the business, making it difficult to achieve a single view of the customer. Even now, only one-fifth of companies in the survey have plans to move to a global IT platform.

Risk and reward. Profitability can depend not just on making money from underwriting, but on controlling risk in an increasingly complex market. No fewer than 76 percent of those questioned in this survey said that improved knowledge of the group's overall exposure was the single most important factor in managing risk. Another important trend, according to several executives interviewed for this report, is anticipated to be for underwriting and the allocation of capital to be tied more closely together in the future.

Asset management. The research indicates a sharp focus on driving new efficiencies from asset management. Forty-three percent of those questioned in this survey reckoned that asset management would be enhanced by the creation of a centralized asset management capability. Forty-one percent of respondents said that their firms should improve returns by removing under-performing asset managers.

Outsourcing. Only a small minority (less than eight percent) of executives said they would outsource over the next three years. The high importance that executives place on quality of customer service may explain the reluctance to hand areas like claims processing over to third parties. Insurers are more comfortable with the idea of internal shared service centers, particularly for back-office functions; approximately one-fifth of executives said they will rely on shared service centers to handle IT and finance within the next three years.

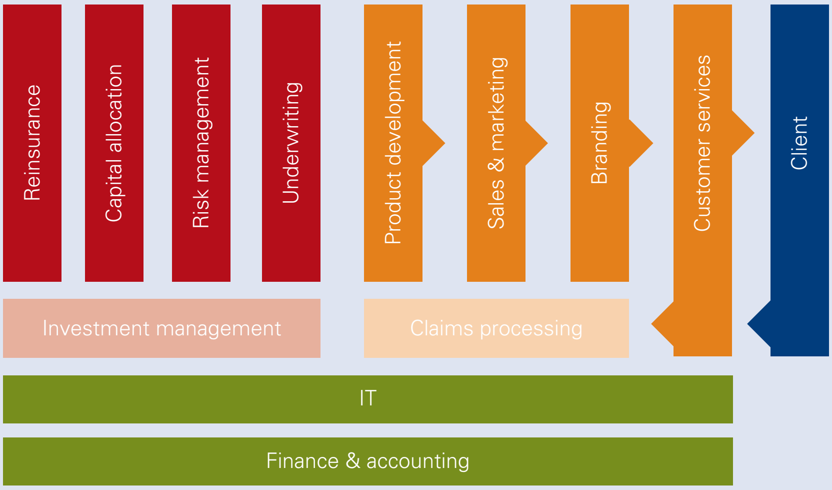
Managing a global business. How should insurers and re-insurers manage their increasingly complex, global operations? The answer depends on which part of the business you have in mind. In the survey, companies indicate that management of the brand is expected to be increasingly centralized on a worldwide basis. By contrast, sales and marketing may need greater autonomy at a local level in order to respond to specific market needs.

In the past, insurance companies have been relatively sheltered from the competitive forces that have reshaped business models in other areas of financial services. But that is changing. As Age Miedema, CIO of ING's intermediary division, puts it: "Customers are no longer prepared to pay for operations that are too complex." Scale, simplicity and customer focus will be extremely important for future success, but achieving those goals may require more than minor modifications to the business model. In the end, restructuring at the industry level may need to be matched by deep-rooted changes to the way individual insurance companies go about their business.

Introduction: Restructuring in the risk business

The pace of change is picking up in the insurance industry. Globalization, regulation, new delivery channels, new customer demands – these are just four of the forces that are causing insurers around the world to reconsider their business models. In response, everything from underwriting to capital allocation, from product development to claims processing and from customer-facing processes to back-office efficiency, is likely to undergo a significant transformation (Figure 1).

Figure 1 An insurance company value chain



Source: KPMG International, 2006

Most of these challenges are not new, but they take on a fresh hue in an increasingly interconnected business environment. As Lord Levene, chairman of Lloyd's of London, commented at a European Insurance Summit in 2003: "Sharing risk that others face on the other side of the Atlantic or the world has been our stock in trade for centuries. The difference today is the pace of trade, the size of the risk and the complexity of the issues we face."

He was talking about Lloyd's, but he could have been speaking for insurers and re-insurers everywhere. Not only is the world becoming a smaller place; it is fast becoming one where the biggest firms are likely to become bigger still, and where a truly global approach to the business of insurance could prove increasingly effective. Lloyd's itself is a good example: more than 30 percent of the market's capital already comes from the U.S. and Bermuda, an up-and-coming center for insurers and re-insurers alike. In return, Lloyd's does an increasing amount of business in America.

Catastrophes like the 9-11 terrorist attacks or last year's spate of hurricanes highlighted how risks carry across a global insurance industry. Of the 10 insurers who faced the largest gross losses from 9-11, only two were American[1]. Of the other eight, one was Bermudan, two were Japanese and the remaining five – including Lloyd's – were European.

Figure 2 Which of the following statements best describes the rate of consolidation in the global insurance industry?

Will begin to/continue to decelerate	8
Will accelerate	49
Don't know	4
Will continue at the same rate	38
Consolidation is not occurring	1

Source: KPMG International, 2006

Similarly the rebuilding of New Orleans and the other areas wrecked by the storms will be anything but a local affair. Such disasters have had the effect of making capital within the insurance market increasingly mobile. Even nimble Lloyd's has been surprised by the speed with which new capital was attracted to Bermuda as premium rates rose in the wake of the hurricanes. Nor is it just the biggest risks in the catastrophe market that are becoming global. Everywhere you look in the insurance world, firms are trying to capitalize on their scale and international reach.

That trend is very much apparent in the global survey of 148 senior executives in insurance companies conducted for this report. Some 49 percent of those questioned predicted that the pace of consolidation is set to accelerate (Figure 2).

Two high-profile deals at the end of last year – Old Mutual's successful tender for control of Skandia and Swiss Re's acquisition of General Electric Insurance Solutions (GEIS), together worth more than U.S.$11 billion – confirms that the process of consolidation has some way to go. Indeed, the nature of Aviva's interest in the Prudential is proof of that. Insurance markets in both the U.S. and continental Europe remain more fragmented than other industries, a sign that we can expect more deals in the coming months and years.

1 EIU

In a parallel trend, firms have already opted out of marginal markets or sold peripheral businesses to concentrate on their core subsidiaries. Around three-quarters of survey respondents said that their company had either left a national market during the past three years by selling its operations, or had done so by closing down an office (Figure 3).

Figure 3 Which of the following has your company done over the last three years and which do you foresee it doing over the next three years?

	Within last three years	Within next three years
Take part in either a merger or an acquisition	55	45
Enter a new national market by purchasing a local firm	48	52
Leave a national market by selling operations there	71	29
Enter a new national market by setting up operations	50	50
Leave a national market by ceasing operations there	79	21
Change head office location	39	61
Enter new lines of business	49	51
Exit any significant financial services lines of business	67	33
Other	33	67

Source: KPMG International, 2006

Take AEGON, an international insurer based in the Netherlands. Last year the company bought Nationwide Poland from the British building society of the same name as a step towards developing its business in eastern and central Europe. AEGON already has an established operation in Hungary and start-ups in the Czech Republic and Slovakia. The business in Poland was Nationwide's only sizeable foreign venture, so it made sense to sell it to somebody who was keen to expand in the region.

Michiel van Katwijk, AEGON's executive vice-president and group treasurer, believes that regulations such as Sarbanes-Oxley in the U.S. and Solvency II in Europe (which aims to tie firms' need for capital more closely to the risks they run) are likely to put larger companies in a stronger position than their smaller brethren. "So we believe over time we will see more deals involving disposals by small companies to large ones," he says.

To survive and compete in this increasingly globalized industry, firms should examine their business models and decide where their strengths lie. Every area of the business model needs to be considered, but the survey suggests that some areas may be of particular importance in enabling insurers to compete on the world stage.

Customer relationships

When asked which components of their business model mattered most in ensuring their competitive position, customer service emerged as the most important priority (cited by 70 percent of respondents). Other customer-facing functions such as branding and sales and marketing were also deemed important (Figure 4).

Figure 4 Please rate the following components of your business model by how important their role is in ensuring your competitive position.
Please rate on a scale of 1 to 5, where 1 = Extremely important and 5 = Not important.

	1	2	3	4	5	Don't know
1. Branding	30	35	19	14	2	0
2. Product development	24	33	22	13	8	0
3. Sales and marketing	29	35	21	7	8	0
4. Underwriting	37	27	12	11	13	0
5. Claims processing	26	35	21	12	6	0
6. Customer service	47	24	11	7	10	1
7. Risk management	35	26	17	10	12	0
8. Finance and accounting	14	29	35	16	5	1
9. Capital allocation	20	32	22	15	10	1
10. Re-insurance	19	28	24	18	8	1
11. Asset management	23	25	25	15	11	1
12. IT	25	33	22	11	8	1

Source: KPMG International, 2006

How, given the new competitive landscape discussed above, will insurers acquire new customers and strengthen their existing relationships? The two main competitive weapons in this regard appear to be creating powerful, global brands on the one hand and highly tailored products on the other. Sixty-five percent of executives in the survey rated branding as an important source of competitive advantage, while 58 percent accorded the same level of importance to product development.

Looking specifically at brand strategy, more than 63 percent of those questioned reckoned that the development of a common brand across all regions was likely to be their company's priority over the next three years or so. This was more than twice the number who thought that their firms would continue to cultivate well-established local brands. Indeed, a growing number of insurers are examining their policy on brands. For example, Fortis recently announced that it was switching to a common brand across its home markets.

Figure 5 What are the major factors that will shape your company's product development strategy over the next three years?
Choose up to three responses.

The need to drive down costs (e.g. cutting product duplication)	40
The need for a common set of products wherever we operate	18
The need to tailor more products to national and local needs	55
We need to significantly improve our product propositions in order to compete effectively	35
The need to innovate in order to achieve product differentiation	55
The need to address the requirements of different national regulatory regimes	22
Other, please specify	1

Source: KPMG International, 2006

Figure 6 What are the major factors that will shape your company's sales and marketing strategy over the next three years?
Choose up to three responses.

We need to drive out great efficiencies by standardizing our distribution channels	33
We need to better meet the needs of our customers by increasingly tailoring products to specific customer segments	72
We need to improve the skills of our customer-facing staff	59
We need to further develop our online distribution channel(s)	34
We need to increase sales by further developing our relationships with IFAs and non-tied sales agents	20
Other, please specify	6

Source: KPMG International, 2006

When asked what was likely to shape their company's strategy on product development over the next three years, over half of respondents pointed to the need to tailor products to meet specific national and local needs (Figure 5). A similar proportion emphasized the need to innovate in order to achieve product differentiation. Interestingly, the need for a highly targeted approach is even more pronounced in sales and marketing, with 72 percent of executives emphasizing the need to tailor the strategy to meet the needs of specific customer segments (Figure 6).

Having used their global brands and tailored products to attract customers, insurers believe they will then need to improve quality of service in two areas in order to keep them happy. One is to introduce, or further develop, their internet claims processing capability, cited by 37 percent of respondents; the other is to improve the quality of their telephone contact centers (35 percent). In both cases, it is clear that IT and communications technology are anticipated to have a critical role to play in supporting these increasingly important service channels.

Risk and capital allocation

"Sixty-one percent of those questioned in this survey said that risk management was important or very important in maintaining their firm's competitive position."

The insurance industry exists to redistribute risk. Doing business on an increasingly global scale can have obvious benefits in enabling companies to spread their risks both geographically and in terms of business lines. As a result, they are less likely to be exposed to the catastrophes that have wiped billions of dollars off the balance sheets of even the largest insurers and re-insurers. Or are they?

There are some within the industry who believe that globalization is not only concentrating risks but, because of the speed with which markets react today, it is increasing the chances of systemic failure. The uncertainty of legal interpretation, particularly under America's tort system, is another worry. As James Schiro, chief executive of Zurich Financial Services, pointed out in a speech at the end of last year: "Whereas a bank's loss is capped by the amount of the loan, insurance losses of claims payments can be potentially unlimited. The outcome depends to a large extent on the interpretation of the contract in light of an evolving jurisprudence." Mr Schiro had in mind not just asbestos, where the industry is still paying for claims based on policies written decades ago. He was also thinking of the law suits filed in America in the wake of hurricane Katrina last fall.

Small wonder therefore that 61 percent of those questioned in this survey said that risk management was important or very important in maintaining their firm's competitive position. But how should companies change the way they operate to guard against such concentrations of risk, whether they come from headline-grabbing disasters or from mundane escalations stemming from risks taken in good faith?

One of the first and biggest challenges is for insurers to understand their total global exposure to risk: three-quarters of survey respondents cited this as the single most important factor in managing risk effectively (Figure 7).

Certainly many underwriters believe that more sophisticated ways of assessing risk (stochastic modeling and the like) have helped them to make improvements. But the industry still needs better safeguards. "It is not a game. You are conducting real insurance," says Robert Chase, head of underwriting for Kiln, one of the largest underwriters in the Lloyd's market. "That is why, where possible, your models need to be based on real experience; and you need to stress test the data to see whether you are in reality."

Over half of executives in the survey believe that underwriting should be tied more closely to levels of exposure. Like other firms operating through Lloyd's, Kiln allocates its capital according to the risks it runs. This means turning away business that is unprofitable and fails to fit a firm's book. During the six months to the end of June last year, when average premium rates declined, the firm accepted only 14 percent of the new business brought to it, down from 23 percent the previous year.

Allocating capital according to the risks run by the individual business units not only makes it easier to match risk and reward; it also makes business units more accountable for the risks they run. Indeed, no fewer than 56 percent of respondents to this survey reckoned that a measure of risk-adjusted performance on economic capital would be embedded within their firms within the next three years (Figure 8).

Figure 7 What are the major factors that will shape your company's risk management strategy over the next three years?
Choose up to two responses.

To assume higher levels of risk in order to enter unfamiliar markets	15
To assume higher levels of risk in order to win market share	16
The need to reduce our level of risk exposure in response to the possible unrecognized risks	29
To improve knowledge of the group's entire risk exposure	76
To manage the threat of large risk events from the convergence of previously unrelated markets	33
Other, please specify	1

Source: KPMG International, 2006

Figure 8 What are the major factors that will shape your company's capital allocation strategy over the next three years?
Choose up to three responses.

Economic capital will be used to assess risk at the level of the enterprise	38
Economic capital will be used to assess risk at the level of the business units	44
Risk-adjusted performance on economic capital will be embedded into our management reporting	56
We will continue to allocate capital based on local supervisory requirements	35
We will continue to allocate capital on the basis of past performance	23
Other, please specify	1

Source: KPMG International, 2006

Asset management

Insurers are also taking another look at the role of asset management. Increasingly, insurers realize that, although it is central to what they offer many of their clients, asset management is not necessarily a core business. Some big insurers such as Zurich Financial Services have already decided to opt out of asset management altogether. Others are looking closely at the idea of pooling or combining their expertise with others. Still others, like France's AXA and Britain's Aviva, have decided to make a virtue of their skills in managing assets and to market them more widely.

"There is a much greater focus now among insurance companies on optimizing their investment capability both through their own internal performance capabilities or, depending on the circumstances, how they leverage external performance capability as part of the product assembly agenda," says Wade McDonald, head of asset management/bancassurance for State Street Investor Services, a global leader in investment servicing.

A lot depends, of course, on whether an insurer manufactures its own investment products or simply re-packages and distributes somebody else's through their channels.

Companies with a strong investment performance clearly have a greater incentive to be seen to be supplying their own investment management as part of the overall service offering.

Just as many asset managers now accept that such things as custody and settlement are no longer central to their business and therefore are better farmed out to others who specialize in them, Wade McDonald believes that insurers can and do outsource asset management where it is no longer deemed to be a core competency. One attraction for insurers operating on a global stage is that they can source capability that is right for each individual or target domicile. By buying into a specific service they can be confident that their partner can comply and keep pace with local regulatory demands.

This may be one reason why 43 percent of those questioned in this survey reckoned that asset management would be enhanced by the creation of a centralized asset management capability. A further 41 percent said separately that their firms should improve returns by removing under-performing asset managers (Figure 9).

Figure 9 **What are the major factors that will shape your company's asset management strategy over the next three years?**
Choose up to three responses.

We need to drive greater efficiencies through outsourcing our current asset management activities	21
We need to drive efficiencies through the creation of a centralized group asset management capability	43
We need to spread our risk exposure by utilizing a higher proportion of multi-manager funds	33
We need to increase returns by utilizing a higher proportion of alternative investments (such as hedge funds)	28
We need to generate greater returns by removing under-performing asset management companies	41
Other, please specify	6

Source: KPMG International, 2006

"Another idea gaining ground is pooling."

Another idea gaining ground is pooling. Under this, an insurer can combine the funds of its clients with those of other companies looking for a similar product or service. The idea works well in offshore centers like Dublin – where, for example, products with registered tax advantages can be sold across the European Union.

True, the idea may take longer to become popular in parts of continental Europe – such as Spain – where bancassurance (the distribution of insurance and investment products through banking networks) has shown some notable successes. Yet it could prove attractive in the markets of northern Europe and the U.K., particularly if legislators succeed in making it easier to sell in a second country of the European Union insurance or investment products originating in another.

The increasing use by insurers of derivatives and securitization to pass on risk, though good for the industry as a whole, has also added to the complexity of administration. AXA and Swiss Re are among insurers recently to have issued securitized bonds valued together at more than U.S.$600 million. This could encourage firms to farm out more bits of their businesses which are outside the core.

As Wade McDonald of State Street points out, unless a firm has the intellectual capital and infrastructure to administer the new levels of asset class complexity, it makes little sense to invest in the administrative support required for these evolving product ranges on an in-house basis.

Core insurance process

"It may be that for insurers, the preferred route to cost-efficiency is through shared service centers."

Customers want great products and services, but the price needs to be right too. In response, insurers may need to bring new efficiencies to the way they deliver these products and services. Increased scale is potentially one way to achieve this, and the survey indicates a shift to centralize many processes. Some, but by no means the majority, of insurers are also experimenting with new service delivery models such as outsourcing and shared service centers. In doing so, they must determine which activities they need to retain in-house, and which make sense to be performed by third parties.

The choice is far from straightforward. Firms attracted by low-cost labor in India, for example, can find not only that the promised savings fail to materialize but that they are left with an inflexible model that fails to adapt to their needs. As Mr van Katwijk of AEGON says, "We have looked at the savings to be had in places like Bangalore and decided that they are not that spectacular – particularly when you consider the level of service for call centers handling American customers that you can get in, for example, Texas."

Indeed, this survey showed that, although there was a definite trend towards centralizing certain functions (such as risk management, capital allocation and asset management), most respondents do not have plans to outsource business functions in the next three years (Figure 10). A strong focus on quality of service, and the need to improve call center performance, may be part of the explanation – at least as far as customer-facing processes are concerned. Even so, it is perhaps surprising that more companies aren't attracted by some of the potential benefits of outsourcing, at least for back-office functions like IT or finance and accounting. It may be that for insurers, the preferred route to cost-efficiency is through shared service centers: one in five companies surveyed intend to use these facilities to handle IT and finance and accounting within three years.

The recent changes in international accounting standards under IFRS have also led firms to pause for thought. These seek to increase the transparency of accounts and to replace outdated notions of historic cost with, where possible, up-to-date market valuations. With Solvency II also expected to come into play throughout the European Union from 2010, firms are keen to simplify finance and accounting processes as much as possible. This may explain why the majority of companies plan to centralize these processes, rather than handle them at the business unit level.

One company looking at the pros and cons of outsourcing is Zurich Financial Services, which does business in 120 countries around the world. Since 2001, the company has re-engineered many of its processes and removed hundreds of millions of dollars-worth of costs. As a result, the company's return on equity doubled between 2002 and 2004.

Figure 10 How do you expect the following components of your business model to be handled by your company in three years time?

	Handled at group level	Handled at business unit level	Placed in internally shared service centers	Outsourced in country of domicile	Offshored to organization owned by our company	Offshored
1. Branding	61	26	9	2	1	1
2. Product development	26	63	6	3	1	1
3. Sales and marketing	21	61	13	3	0	2
4. Underwriting	24	58	10	6	1	1
5. Claims processing	20	51	16	8	3	2
6. Customer service	13	64	13	5	4	1
7. Risk management	51	34	9	4	1	1
8. Finance and accounting	45	32	18	2	2	1
9. Capital allocation	70	17	8	4	1	0
10. Re-insurance	52	31	11	4	1	1
11. Asset management	70	13	11	4	1	1
12. IT	40	31	19	6	4	0

Source: KPMG International, 2006

To reduce costs, Zurich did two outsourcing deals at the outset worth around U.S.$1.5 billion a year: one for hardware, the other for software. Yet, says Daniel Hofman, chief economist and head of public relations, when it came to call centers the company decided to group various regional facilities together under one roof rather than outsource them. That way, he says, the firm got many of the synergies it was looking for without the additional worries of outsourcing.

Which way a firm turns, it seems, depends partly on culture and partly on how flexible it needs to be in spreading its wings internationally. Priorities can also change. “It is horses for courses,” says AEGON’s Mr van Katwijk.

This is a view supported by Age Mediema, chief information officer of ING’s intermediary division. While the savings to be gained by outsourcing or moving operations offshore are tempting, he believes that firms should be careful to weigh up the advantages and disadvantages before jumping. Companies should keep their options open.

“There will be no big bang at ING,” he says. “The process will be gradual.” Each step should be measured against the prospects for the businesses involved and whether or not they are mature enough to justify such moves.

The role of IT

"IT is also seen as an important source of competitive advantage by 55 percent of companies in the survey."

IT is also seen as an important source of competitive advantage by 55 percent of companies in the survey. Used effectively, it can play a critical role in helping companies to increase efficiency and flexibility across their global operations. Almost half of executives say their company's IT strategy now needs to focus on boosting productivity, for example (Figure 11).

Figure 11 What are the major factors that will shape your company's IT strategy over the next three years? Choose up to three responses.

The need to have more operations at the global level	23
The need to enter new markets	27
The need to move functions to previously unsuitable locations	8
To accelerate the development of new products	38
The need to accelerate our entry into new markets	16
To enable us to tailor more products to national and local needs	28
To achieve greater uniformity in how we sell insurance	16
To enable us to boost productivity through efficiencies and outsourcing	45
The need to improve quality	37
Faster claims processing	12
Other	3

Source: KPMG International, 2006

These goals are likely to require a move to more standardized IT systems and processes. In the past, the benefits of IT have been eroded because different departments have used different systems. This mixture of applications and databases can make it difficult to exchange data seamlessly across a global organization, and may make it difficult to guarantee the accuracy and integrity of data required for reporting and compliance processes. It also makes it exceedingly difficult for some insurers to achieve a single view of the customer, a step that is regarded by many as a prerequisite for improving customer relationship management.

Ted Devine, executive vice president and head of corporate strategy at Aon, an American broker that operates in 120 countries worldwide, believes that an international firm with a sophisticated IT platform not only appeals to truly global clients, but also to regional customers: the former needs to model risks around the globe in order to stay on top of its exposures, while the latter based in, say, São Paulo needs access to the latest technology so it can benchmark its own performance against the large global corporates of this world.

AXA is another firm believer in the need for a coherent IT strategy to support its international business. The company has developed a system in Asia that has proved so successful that it is to be rolled out in other regions. At its base is a common IT platform which allows records, claims and the like to be accessed from any office in Asia without the need to send physical files from one place to another.

"One of the benefits of the system is that it leaves an audit trail. So, wherever you are in the region, you can quickly see what has been done to a particular document or file and where it was done from," says Victor Kuk, head of AXA's General Insurance Hong Kong office with responsibility, among other things, for information technology across the Asia Pacific region.

The message is that as companies expand their operations, standardized IT systems and processes can help improve flexibility and efficiency. But many companies are a long way from achieving this goal. Indeed, only 21 percent said their firms planned to centralize their IT operations on a global model within the next three years. The rest may well find that their expanded operations are less easy to run with efficiency than they had imagined.

New organizational structures

"The picture then is clear. Globalization requires greater control at the group level for areas such as branding because these reflect the identity that a company portrays worldwide."

As insurance companies go global, which business operations should they centralize, and which should be managed locally? The answer, according to this survey, differs from one business function to another. On branding, for example, a distinct majority (63 percent) of respondents said that their employer currently handles all such work at group level. This proportion remains more or less the same when respondents are asked to peer ahead over the next three years or so. The story is very different, however, when it comes to sales and marketing, product development, and customer servicing. In such cases, over 70 percent of those questioned said that these things were handled by the business unit in question.

The picture then is clear. Globalization requires greater control at the group level for areas such as branding because these reflect the identity that a company portrays worldwide. But the detail of shaping products and services to suit local conditions, as well as keeping in touch with customers, should be managed at the level of the business unit or the local office.

One of the best ways to achieve this balance is by using a matrix structure for managers. For AXA's Asian operations, the brand and its application to all products and services are controlled by guidelines set out at group level. Each office focuses on its own sales and marketing but, thanks to a matrix structure, receives input from others in the region. This enables the region as a whole to function with a surprising degree of autonomy but helps to ensure that disciplines are maintained. As a result, the firm gets closer to its customers while maintaining control over the things, such as branding, that can affect the firm's reputation overall.

U.S. listed insurer ACE became one of the most international of insurers when, in 1999, it acquired CIGNA's non-life operations. This gave the enlarged company a network of businesses spanning some 14 countries in Asia. Like AXA, the group operates a matrix system of reporting.

"We are very autonomous in the region but operate within a clear policy laid down at group level," says Neil Spettigue, ACE's chief financial officer for Asia Pacific, who presides over the company's finances throughout Asia, Australia and New Zealand. Unsurprisingly, he reports along dual lines to the company's finance chiefs in the U.S. and to the Regional President for the Asia Pacific region, based in Singapore.

It is not just regional business models that are under pressure to change. Domestic ones are too. Even in Germany, traditionalists are in retreat. As part of a restructuring completed at the end of last year, Allianz created an independent sales group uniting the activities of its three main subsidiaries in Germany. These cover property as well as life insurance. "We are simplifying the structure and streamlining our processes," said Hansjörg Cramer, the group's new head.

"In the future, a significantly smaller number of people will be involved in decision-making, which will make a huge difference in terms of speed and efficiency. Consequently, we will be able to strengthen our already excellent position against the competition," he said.

Conclusion

There is little doubt that the changing nature of risks and the increasing globalization of insurance at many levels is forcing even the most traditional of operators to re-think their business plans. Firms are ruling nothing out in an attempt to remain competitive in a market that has shown itself, particularly when it comes to catastrophe cover, to be as cyclical as ever. As shareholders demand more value, so insurers are being forced to look at their businesses from several points of view.

The complexity that has tied down the industry at various levels is being challenged, and not before time. Customers are no longer willing to pay for indifferent products and services supported by expensive and creaking infrastructures. The Internet has taught retail customers that ‘going direct’ can be cheaper. In the wholesale markets, globalization is forcing even niche players to raise their game.

As a result, companies are taking a fresh look at their branding and marketing. Successful companies like AXA have demonstrated the increasing power of global brands, even where distribution remains fragmented. The next five years are likely to see further consolidation not just at a corporate level but at the sharp end of the business where it affects customers. Firms which show a willingness to examine various aspects of their business model – and, if necessary, to change it for one better suited to a global market – are likely to come out on top.

Outsourcing in search of value

Whoever you are and whatever you want, it seems, specialists in business process outsourcing (BPO) have something to offer. That, at least, is the sales pitch. Yet, having helped a raft of companies in financial services to re-engineer their businesses and, in the process, to save on average between 25 percent and 30 percent of their costs, it is no idle boast.

These days, too, it is not just Indian firms that are keen to offer their services; a host of providers from such places as China, the Philippines, South Africa, parts of Latin America and the emerging countries of Eastern Europe are also keen to ply their trade. They may have different skills and varying levels of experience but they all have at least one thing in common: lower costs than insurance companies domiciled in developed countries.

One of the largest and oldest companies offering BPO from India is Wipro. With four out of the top 20 insurers in the U.K. as clients, Wipro thinks it knows how BPO is likely to develop.

“If you are an insurance company operating a global business model, what you want is for your infrastructure to operate 24 hours a day, seven days a week. This has been in vogue since at least 2004,” says Ajoy Menon, a spokesman for Wipro.

"What companies want now is to be able to deliver value. If an insurance company buys another, the strategy is usually to realize the benefits within a year or so. It can therefore help in delivering that value to have a global business model supported by an outsourcing agreement."

Such an approach goes hand-in-hand, says Mr Menon, with the idea that, in order to remain competitive, insurers need to concentrate on the things they do best – such as underwriting, branding, and sales and marketing. The rest can be left to those who believe they have the skills, scale and cost structure to help the customer deliver the value to shareholders. It sounds good in theory and, for some, clearly also works in practice.

A few good re-insurers

Nowhere is the industry more concentrated than among re-insurers. Eight large centers accounted for more than 90 percent of the U.S.$170 billion of premiums written in 2004, according to a new study by the Group of Thirty, a collection of advisers on international finance. The 10 biggest groups by premiums written accounted for around 60 percent of the market, up from 40 percent a decade or so ago.

The concentration is greater within life and health re-insurance, which is usually sold directly, than in property and casualty, which tends to be sold through brokers. Is it a danger? Not necessarily, says the Group of Thirty. But the effect on capital markets of re-insurance risk is likely to grow over time as more of it is securitized.

Indeed, it may be in everybody's interest were the re-insurance industry to become more transparent and securitization easier. The trouble is, says the report, regulators have yet to take a sufficiently global view of re-insurance, which could increase the risk of systemic failure and have a knock-on effect on capital markets in general.

Potentially the more that insured risks are transferred to capital markets through securitization, the greater the need for better risk management, says the report. Closer attention to regulatory capital could also help. This is something with which many credit-rating agencies, on whom re-insurers rely in order to securitize their risks, are likely to agree.

The impact of Solvency II

In order to protect policyholders' interests, Solvency II seeks to tie insurers' capital more closely to the risks they run. From 2010, member states of the European Union will have to adopt a framework which will set out such things as the technical constraints on capital and the measures needed to enforce the standard. The initiative is likely to favor large, diversified insurers over small, riskier ones.

Are insurers' systems for managing risk and allocating capital as up to date as they should be? The answer is probably no. When asked what would shape their firms' risk management strategies over the next three years, no fewer than 76 percent of respondents pointed to an improvement in the level of knowledge about the company's entire exposure to risk.

This could mean that some firms with a mix of businesses – such as life assurance, property and casualty insurance, and retail and commercial banking – are still getting to grips with the nuances required of a combination of Solvency II and Basel II (which affects banking). Firms are already beginning to shift risks from one offshoot to another to secure better credit ratings and so to raise money on finer terms.

It could also suggest, however, that insurers in general have been slow to introduce a form of economic capital (which allocates capital according to the risk business units run). Such systems can not only make it easier to help determine which businesses return most for the capital employed and the risks taken; they also help to ensure that managers' rewards take into account the risks they run. This may be why some 56 percent of respondents said that their firms plan to embed a form of risk-adjusted performance measurement over the next three years or so.

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