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P&C INSURER OPERATIONS: HAVE YOUR CAKE & EAT IT TOO

While the need for efficient & flexible P&C insurance operations isn't new, a convergence of evolving P&C trends is causing Carrier Management to re-think traditionally defined lines between concepts like insourcing & out-sourcing. Modern-day restroom politics aside, the model need not be so binary. A more thoughtful, blended approach enables insurers to fortify & enhance their existing teams vs. replacing them. Perhaps "**All or Nothing**" isn't the smartest (or safest) play.

If you prefer to skip straight to the answers, by all means scroll to page 4 - GAME PLAN FOR INSURERS. If you're first curious about a bit of the strategy & context, feel free to continue perusing directly below...

1. YES, MORE WORDS ON THE P&C TALENT GAP

Perhaps you haven't heard; there's a deepening talent shortage in our business. If you work at a P&C insurer you're likely experiencing it either directly or indirectly now. Conceptually it makes sense: Baby Boomers are retiring, Millennials generally aren't attracted to insurance, mix in low unemployment rates, and voilà – the situation is deteriorating. We won't allocate too much real estate here because the problem is so well-known, but the numbers do underscore what's unfolding:

- **Unemployment Rates:** Since U.S. unemployment peaked at around 10% following the 2008–09 financial crisis, recovery in the job market dragged the unemployment rate to its lowest level, at 3.9%, since 2000. The unemployment rate has now dropped even lower to 3.7% as of June 2019. Tight labor market = more difficult and expensive to attract (& retain) the right talent.

- **P&C Talent Conditions:** The U.S. Bureau of Labor Statistics reports current insurance industry employment stands at 2.5 million workers. The number of insurance professionals age 55 and older has increased 74 percent in the past 10 years. And with 25 percent of industry employees having expected to retire by the end of 2018, it's projected that 400,000 insurance jobs will need to be filled by 2020. Currently, approximately 27 percent of insurance professionals are under the age of 35. The industry's future lies with the millennial generation – but current statistics show our industry is lagging in attracting them. According to the Insurance Information Institute, 8 out of 10 Millennials are unfamiliar with insurance industry career opportunities.

In the P&C sector, US premiums written grew 4.6% in 2017, the highest percentage in the past decade, before jumping by 12.7% in the first half of 2018. US P&C carriers have seen their insurable exposure base continuing to expand across both personal & commercial lines, due in part to faster GDP gains, shrinking unemployment, & higher consumer spending (source: Deloitte Research). All told Net Written Premiums grew 10.8% in 2018 on account of organic premium growth and changes some insurers implemented on reinsurance arrangements (source: ISO).

Admittedly, profitability can be old-fashioned and outdated thinking these days. But unless you're Jeff Bezos what's the point of growth if it's not reasonably cost-efficient? What's the best way to support said growth? More on this in a moment…

2. WHAT'S BETTER THAN GROWTH? EFFICIENT GROWTH

3. PROFITABLE? YEAH, BUT...

U.S. P&C carriers had a marginally profitable year in 2018, roughly breaking even on underwriting and slightly increasing investment returns. While 2018 U.S. catastrophe losses declined from 2017, insurers remain guarded because global insured catastrophe losses continued at a record pace and the fourth-quarter U.S. combined ratio spiked to 104.6 percent (source: APCIA). Consider the following:

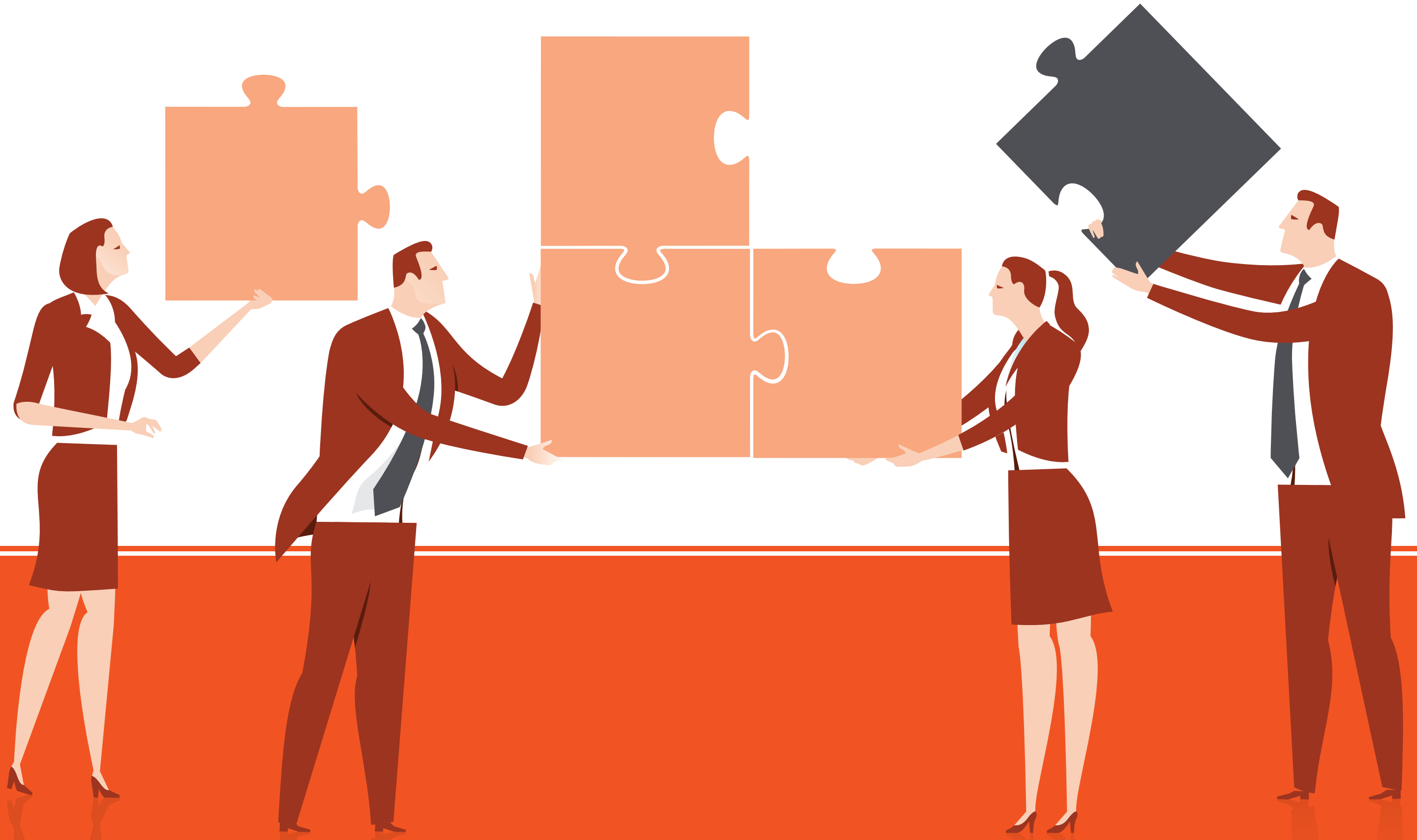
- Total economic losses from hurricanes in 2017 were nearly five times the average of the preceding 16 years, losses from wildfire were four times higher, and losses from other severe storms were 60 percent higher (source: Aon Benfield).
- Total global economic losses from natural disasters between 2005 and 2015 were more than 1.3 trillion, with total direct losses in the range of $2.5 trillion since 2000; the series of major hurricanes and other natural disasters in 2017 made the year of highest insured losses ever at $138 billion; overall economic losses from natural disasters in 2017 amounted to $340 billion, the second highest annual figure ever (source: MunichRe).
- Analysis by MunichRe has identified a long-term trend in an increase in the number of natural catastrophes around the globe, predominantly attributable to weather-related events like storms and floods. As there has been no relevant increase in geophysical events such as earthquakes, tsunamis, and volcanic eruptions, there is some justification in assuming that changes in the atmosphere, and global warming in particular, play a relevant role (source: MunichRe).

Beyond buoying cost pressures with operations efficiency, given the above trends flexible scale (up & down) might not be a bad idea either.

While 2018 and 2019 are shaping up to be strong years for insurers overall, concerns are beginning to be raised about some economic slowdown in the early 2020s. Some pundits worry about the potential for ongoing disputes between the United States and China as well as other nations over tariffs and trade rules. Meanwhile, others project the economic stimulus from federal tax cuts and additional government spending to ramp down by 2020. One warning sign cited by economists has been a flattening yield curve between short and long term interest rates - a development that has historically indicated a recession in the years ahead (source: Deloitte research).

Thoughtfully blended variable cost support can buffer some pain in the inevitable down cycles, too.

4. IT DOESN'T GO THE OTHER WAY, DOES IT?



GAME PLAN FOR INSURERS

As opposed to a broad brush / "Lift n' Shift" / All-or-Nothing strategy, supplementing internal teams with pockets of external support can help carriers optimize their operating model. It should be **custom**; one size need not fit all. To be clear: this isn't to describe simple staff augmentation, which isn't cost effective at scale (and lacks management, reporting / insights, quality programs etc.). But rather, a blend of traditionally defined staff augmentation & traditionally defined outsourcing:

⊗ DON'T:

- Necessarily cede control of entire functions
- Drift too far from controlling the customer experience & potential brand impacts
- Be forced into using an outsourcing vendor's sub-standard systems
- Risk communication, quality, and timing impacts by shifting key activities offshore
- Become "operational hostage" to an outsourcing company

DO:

- Mitigate talent gaps; free up existing resources to focus on higher value work
- Stem capacity constraints, diversify operational risk, and achieve flexible scale (up & down)
- Achieve cost efficiency by migrating portions of an operation to variable cost models
- Enhance operations with external "value-add" capabilities
- Move faster

HOW?

Consider supplementing or re-aligning operations by:

- **Volumes:** Offload calls or transactions in excess of defined volume thresholds.
- **Components Within a Function:** Obtain support for certain transaction types (i.e. endorsements, renewal processing etc.), certain call types (i.e. payments / billing), underwriting support subsets (i.e. inspection reviews), etc.
- **Major Initiatives:** Backfill current staff that's being pulled into large-scale platform & related projects.
- **Staff Counts:** Internal headcounts are capped at x; capacity overages are handled externally.
- **Technology Platform:** Operations support tied to specific systems are performed by a partner.
- **Portions of the Book:** External support is engaged for specific products, states, runoff programs, etc.
- **Talent Types:** E.g. if licensed producers are required for sales support activities, service center models, etc.
- **Strategic Acquisitions:** Realize deal synergies faster by migrating acquired operations to a more efficient operating entity.
- **Automation Outliers:** Offload the "messy remainders" that automation doesn't fully accommodate.
- **"InsurTech" Value Proposition:** If technology innovation is the core competency, engage a partner for operational aspects that do require some forms of staffing.
- Other logical operations segments…

CREATIVITY AND INSURANCE OPERATIONS NEED NOT MAKE STRANGE BEDFELLOWS.

TODAY'S INSURERS ARE WISE TO THINK HOLISTICALLY ABOUT BLENDED, OPTIMIZED, AND CUSTOM OPERATING MODELS TO BOTH SAFEGUARD AND DRIVE COMPETITIVE POSITIONING.

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