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An Insurance Perspective

Tempering optimism with realism, Eric Smith, chief executive officer and president of Swiss Re Americas, sits down with Laura Hay, national Sector Leader of KPMG's Insurance practice, to provide his view on the current condition of the industry and a set of recommendations on a way forward.

Insurance industry leaders can take the industry on a new trajectory of growth, he believes, by embracing what he describes as the three R's: *Responsibility*, *Revolution*, and *Relationships*. The interview is based on comments Eric delivered as a keynote speaker at the 2012 KPMG Insurance Industry Conference, where he reminded his colleagues that resilience hinges on adaptation and determination.

Laura Hay: You have an interesting message, Eric. We often only hear about the turmoil and issues surrounding prices, rates, margins, and regulations. Your point about adaptation and resilience is encouraging.

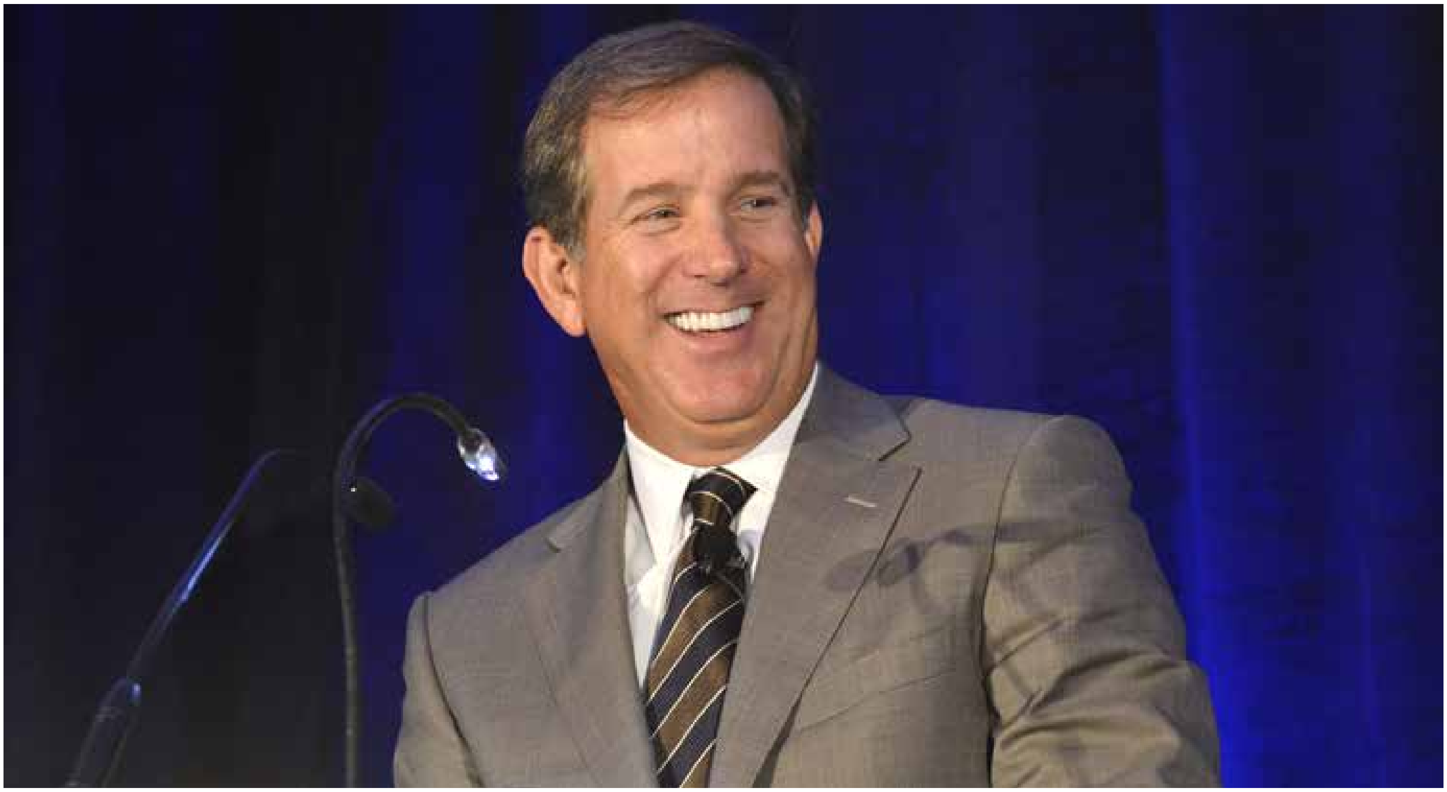
Eric Smith: I've been fortunate to be part of this industry long enough to have a broad perspective about growth and change. From where I stand, I take a different view than those who only see our industry right now as one that is stuck in a rut of low interest rates, depleted reserves, and a sluggish economy. While those people have a point about economic conditions and the impact those conditions are having, this industry is by no measure stuck. What I see, instead, is transformation driven by technology, by consumer demands, and by changing behaviors.

Laura Hay: What are the aspects of transformation that you believe aren't being heard within the industry?

Eric Smith: Our industry is on the move, and like most transformations, this one poses a choice: resist or embrace. And that question ultimately leads to another: Will we seek to adapt, or merely to endure? Will we embrace for ourselves the resilience we make possible for others?

Laura Hay: Given those questions, where do you think we are headed?

Eric Smith: A sector that facilitates resilience—that makes it possible to take the thoughtful risk such as investing in the new business or expand into new terrain—had better display resilience itself. And, in large part, I believe the insurance industry embodies the idea that the true measure of resilience is not simply enduring adversity but adapting to it.



Because businesses that adapt—like species in natural selection—emerge not merely intact but transformed. And what Darwin said about the origin of species applies in equal measure to the survival of sectors. Companies, like species, either adapt or wither.

Having said that, I think it also is very important to understand that adaptation of businesses differs from that of species in one decisive respect: Natural selection depends on random variation. Our industry's survival depends on deliberate planning that is conscious and careful, thoughtful and forthright. What is becoming so obvious these days is, we have at least some choices about *how* we adapt, yet no choice *but* to adapt.

Laura Hay: The weak U.S. economy is lessening demand for non-life insurance cover, and insurers were severely impaired by last year's cat losses. At the same time, many buyers aren't responding to traditional sales tactics and they aren't using agents as much as they did in the past. They think insurance products are more like commodities or too much of a hassle to obtain. We're also seeing the trend in life insurance where the middle class is vastly underinsured despite needing to plan for longer lives, longer retirements, and growing health issues. All-in-all, isn't it difficult to argue with people who say the industry is in trouble?

Eric Smith: It's true—these truly are challenging times. I can't argue that, but I believe adversity compels adaptation. We have the opportunity—*if we embrace it*—to emerge stronger on the other side. So, given the choice, do we wring our hands, or roll up our sleeves? I'm an optimist … but a rational one. Opportunities do exist in this environment. If we embody resilience we will find the possibilities amid peril.

Laura Hay: What's your advice on how to find those opportunities, especially given all the pressures that are facing everyone from the executive suite to the local agent's office?

Eric Smith: To make our way out of any rut, we need to embrace the three R's of resilience, which are Responsibility, Revolution, and Relationships. I'm talking about *Responsibility* in underwriting, *Revolution* in technology, and *Relationships* with customers that must grow both broad and deep.

Laura Hay: In your comments at the conference, when you discussed responsibility, you mentioned that recklessness and resilience never mix.

Eric Smith: That's right. Given the market conditions underwriters face, the seduction of volume entices us all: sell anything, underwrite everything. But like man on bread, underwriters cannot live on volume alone. Quantity without regard to quality will lead to crisis. Like most temptations, giving in to this one is ultimately an act of laziness, not resilience. Recklessness is not an adaptation. It's a dodge. This is a moment for old-fashioned underwriting discipline, not in spite of the environment but because of it—because this economy has reduced our margin for mistakes. But that's exactly why discipline is so key. These challenges aren't simply obstacles. They're opportunities.

Laura Hay: On the topic of *revolution* in technology, you focused on several aspects of connectivity.

Eric Smith: Technology tends to break in two waves. It's used to automate old tasks, and then it starts transforming—when old tasks give way to new possibilities. That's the cusp on which I believe the insurance business stands today—if we adapt. By technology, I don't mean merely souped-up servers back at the home office. That's part of the answer. What really has the potential to drive a transformation is technology in the hands of consumers.

The essence of what Apple has taught us is that true innovation does not merely meet market needs. It creates them. I believe an embrace of both mobile and desktop technology is the key to delivering insurance to the middle market. A number of life insurers are now offering electronic underwriting—replacing the old system of blood tests and underwriting reviews with algorithms that use simple data to predict risk and determine insurability. It's not just a matter of efficiency. It's about convenience.

Technological innovation is happening on the P&C underwriting side of the business too. Consider the case of telematics, which makes it possible to assess risk at the individual rather than the demographic level. In these ways and others, technology is enabling more comprehensive, personal, and accurate models for assessing risk.

Predictive analytics, too, is enabling everyone from baseball scouts to underwriters to analyze data and forecast what the future holds—whether it is how many runs a right fielder will drive in or the damage a coming hurricane season will inflict.

Laura Hay: The foundation of our business is how we build and maintain relationships, but we are seeing that commoditization of insurance products is threatening how the industry interacts with customers.

Eric Smith: The danger associated with commoditization ranks alongside low rates and falling reserves. Low rates cost us returns. But commoditization costs us relationships. Commoditization isn't an adaptation. It is merely an attempt to force everyone to the lowest price point and to compete on rates alone. That doesn't enable resilience for anyone—not for insurers and not, crucially, for our customers.

The idea that economic return is all that matters threatens our relationship with customers, regardless of economic conditions. We don't eat at the cheapest restaurant if the service is slow and the food poor. We don't buy the least expensive but least reliable car. In those areas of economic life—and others—we balance service, quality, and price. And so do our customers.

In my view, commoditization can be resisted in two ways. The first is to provide superior service, which, of course, is true in any industry. But, it is especially so in insurance. When our customers need us most is exactly when they can tolerate poor

service the least. Their touch points come at times of calamity and catastrophe. Those are not the times when customers can afford to wait hours for a call to be returned or even to spend minutes navigating an overly complex telephone menu. And it is certainly no time for hearing the company you trusted can't back up the policy it sold.

The second way we can resist commoditization and build relationships is to provide a broad array of products rather than burrowing ever deeper into subspecialties alone. Consumers are prepared—indeed, I believe they prefer—to buy a range of different products at the same source. The family that buys health insurance is also in the market for a range of other risk management tools, from property to life. Relationships of that breadth provide intangible value to customers beyond simple economics, and transform insurance into a relationship—thus resisting the slippery slope of commoditization and fostering resilience.

Laura Hay: Speaking of relationships that we must maintain, what about our relationship with a new generation of employees. Things are changing rapidly on that front.

Eric Smith: That's very true. Talent is important in boom times or bust. A strong underwriting team, alongside a solid sales and customer service team, always makes the difference between a company on solid footing and one on shaky ground.

But to maintain that, we must recognize that younger employees' attitudes have fundamentally changed. They place a low priority on stability and have a higher tolerance for risk. They don't see employers as loyal to them, so they're far less restrained by any notion of loyalty toward their employers. Nor do they think twice about dropping everything—job included—to wander off on a months-long experience, whether it is teaching kids in an inner city or indulging themselves in a trip overseas.

I believe it is a mistake to resist these trends. They are realities, whether we choose to recognize them or not, and they will fundamentally change the way we work in the future. This new generation of employees is not going to love this industry as much as we do if we're hung up on sitting them in a cube and enforcing dress codes.

The answer, as with most change, is to embrace it—get ahead of it—rather than resent it or resist it. The answer is flexible hiring arrangements that accept—embrace—the fact that younger employees are defining work in ways that are starkly different from our definition.

That's not true merely of members of Gen X or Gen Y. It holds for my generation—the Baby Boomers—as well. Millions of them are headed into retirement—whether by force or by choice—with usable skills in tow. All they need are the flexible arrangements that will enable them to apply those skills without working full-time. And we'd be fools to allow a talent pool of that size and experience to pass us by simply because we weren't flexible enough to adapt.

Laura Hay: All of what you describe seems like it will require an enormous amount of effort, especially as all of these forces seem to be converging at the same time.

Eric Smith: There is no denying that, Laura, but I have faith that we can do all this—and more. But the nature of adaptation is that the most promising improvements are the ones we have yet to imagine, and that's where I want to emphasize. Because if we refuse to be satisfied with survival alone—if we insist on adaptation—then new possibilities, some of which lie over the horizon of our imagination, await. I believe we can seize those possibilities.

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