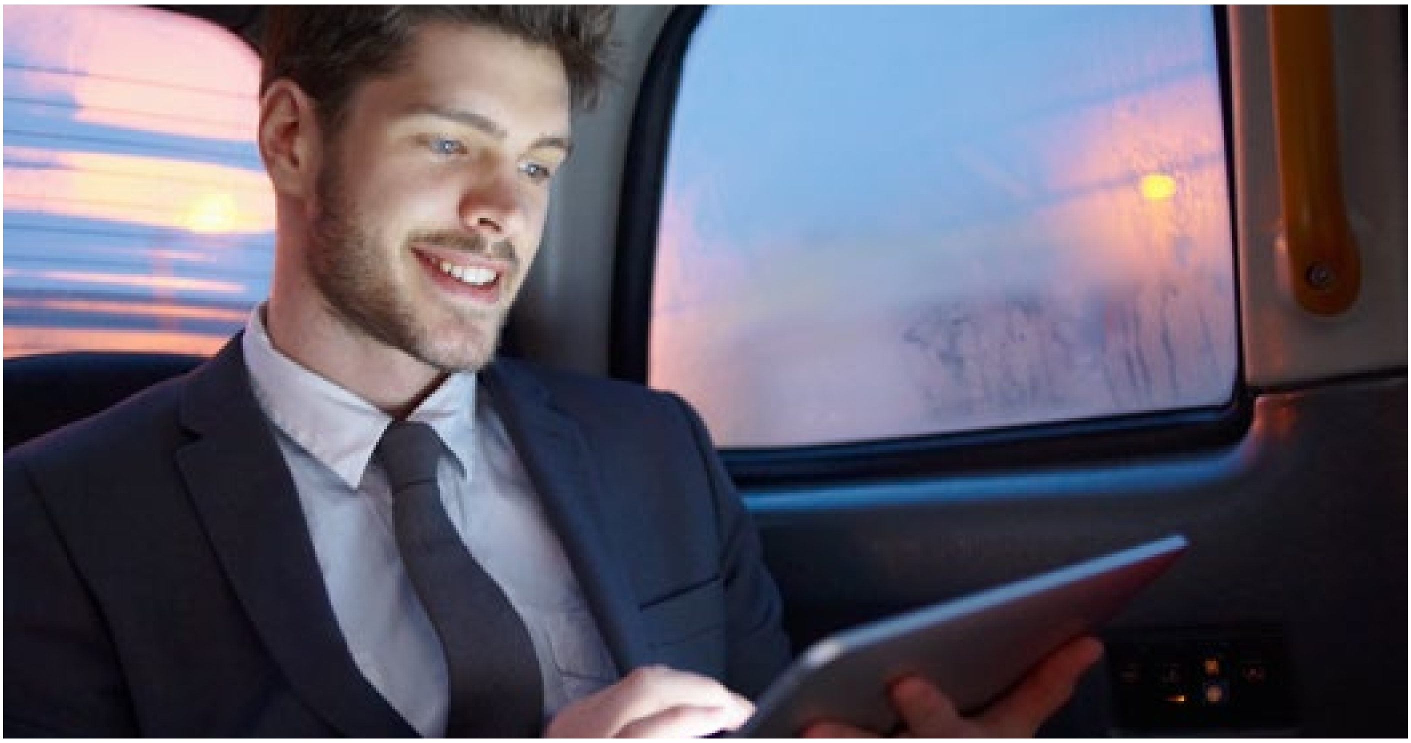
cutting through complexity



Tapping into insurance FinTech: Own it, lease it or share it?

Martin Blake, KPMG Australia
Sam Evans, KPMG in the UK
Ralf Baukloh, KPMG in Germany
Eddie Short, KPMG in the UK

Facing increasing pressure on performance and a growing desire to get closer to their customers, most insurers are now looking for virtually any technology that may help them get – and keep – a competitive edge. Not surprisingly, activity in the Financial Technology sector (better known as FinTech) has exploded with insurers actively competing head-on with banks, private equity firms and global technology companies to secure some of the latest technologies.

Rather than snapping up the latest technology and forcing it onto the organisation, today's insurers seem to be taking a variety of approaches to securing FinTech innovations, often running multiple initiatives at the same time. And in doing so, many are finding that 'owning' the technology may not be as important as they once believed.

Pressure for change

Over the past decade, the pace of change in the insurance sector has been unprecedented with new models, new competitors, new technologies and new regulations quickly changing the rules of the game for insurers around the world. All signs seem to indicate that the pace of change is only going to increase in the future.

Indeed, tomorrow's insurance customer is likely to be even more demanding – and potentially less loyal – driven by increasing demand for a more personalised service level that delivers immediacy, simplicity and transparency. As a result, competition for customers is also moving into hyperdrive catalysed (in large part) by the emergence of a set of new non-traditional players who are using technology and data to create a new value proposition to the market.

Competition heats up

The idea of leveraging technology to improve customer experience and business performance is certainly not new to the insurance sector. The widespread adoption of telematics for auto insurance policies, for example, shows how open the sector can be to incorporating new technologies into the business model. And most insurers are already using some form of data and analytics (D&A) to improve their customer segmentation and experience.

However, the rapid introduction of new technologies such as telematics also demonstrated to insurance executives just how quickly the market could be disrupted by a 'good idea' or non-traditional competitor. Technology suddenly rocketed up the insurance agenda and FinTech – long the darling of the banking sector – became the new 'hot topic' at insurance gatherings and conferences.

Competition for the newest financial services technologies has become fierce. In 2008, FinTech firms attracted just US$100 million in financing; by 2013, that number had increased to more than US$3 billion. And it's not just insurers and banks that are fighting to secure the 'next big thing'; private equity and venture capital houses have also proven to be voracious for deals in the FinTech sector. Some estimates suggest that total global investments into FinTech may have topped US$7 billion in 2014.[1]

Governments, too, are vying to attract FinTech start-ups, incubators and talent. Sydney, Australia, for example, recently launched a new FinTech hub – known as Stone and Chalk – in an effort to improve collaboration between FinTech start-ups and industry while providing access to the '4 Cs' needed for successful incubation: **capital, collaboration, connections and coaching**. Sydney's hub brings the city in competition with other existing FinTech centers such as Silicon Valley, New York, London, Berlin, Tel Aviv, Singapore and Hong Kong.

Incubating innovation

Against a backdrop of strong competition and rising prices for new technologies, a growing number of insurers have started to take matters into their own hands by developing their own technology incubators or venture capital funds. In 2013, AXA set up the AXA Lab in Silicon Valley with the stated aim of accelerating the groups' digital transformation.[2] Allianz's Digital Accelerator initiative, also launched in 2013, is focused on building new business models that can ultimately better serve and build value for their customers.[3]

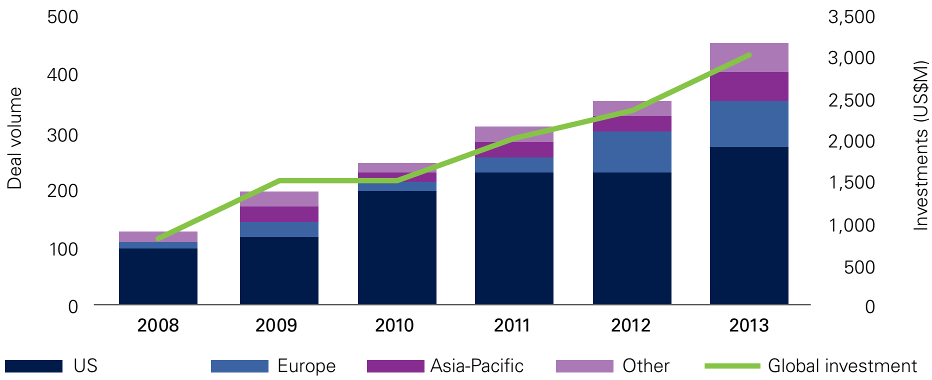
By taking this approach, both organisations have seemingly recognised that their existing corporate culture may not be conducive to incubating and growing new – and more radical – ideas. Allianz's group, for example, makes it clear that they are looking for 'partnerships' for the testing of new business models but categorically denies any interest in 'taking control' of the technology or idea.

> Over the past decade, the pace of change in the insurance sector has been unprecedented with new models, new competitors, new technologies and new regulations quickly changing the rules of the game for insurers around the world.

Group-level labs can also help reduce some of the disruption that often comes with the introduction of new ideas into the insurance sector. The reality is that changing an insurance business is a complex endeavor and many insurers suffer from a type of 'back-book inertia' that prioritises the protection of the existing book of business over the need for long-term change. One of the stated missions for AXA's initiative, therefore, is to help change the culture within the wider Group to become more accepting of new technologies.

Another key benefit of elevating 'labs' to the group level is that organisations are freeing their innovation machines from the (often short-term) financial pressures of the business, thereby affording them greater flexibility and autonomy in the development process. For entrepreneurs who want to keep some level of control over their new ideas, the labs approach can be very appealing.

FinTech financing activity (US$)



Source: Pitchbook Accenture: CB Insights.

1 http://www.statista.com/statistics/376891/value-of-global-fintech-investment-areas/
2 http://www.axa.com/en/news/2013/f1a097vwo1pxn59s4zwl.aspx
3 http://digital-accelerator.com/#

The right model for the right strategy

Insurance executives will need to consider a number of key questions as they develop their optimal FinTech investment strategy.

Strategy development
- What are you trying to achieve?
- How much control do you require over the technology?
- What is your long-term vision for the technology or innovation?

Partner selection
- Which organisations currently have the capabilities or technologies you require?
- How will you prioritise partner identification and selection?
- What is the right way to approach the new partner?

Due diligence
- Do you know exactly what you are investing in and what you will receive in return?
- Have you assessed any and all third party risks?
- Have you created key performance indicators and metrics to monitor progress?

Valuation
- What is the appropriate way to value the investment?
- What are the associated implementation costs?

Post-deal considerations
- What changes are required to your operating model to embrace and maximise value from the investment?
- How will you integrate two potentially very different cultures?
- Who will own any new innovations or technologies that emerge?
- What Transitional Service Agreements may be required to integrate the operations?

Sharing risks and benefits

While Allianz and AXA may be taking a more independent path, other insurers are creating their own models for tapping into new FinTech innovations. The Ergo Insurance Group, for example, has partnered with Axel Springer, a Berlin-based technology accelerator, to focus on 'innovation in new technologies' and to encourage new start-ups in the FinTech sector.[4] The Talanx Group teamed up with Mercedes-Benz and Bosch in an initiative called Startupbootcamp in order to share not only new ideas but (presumably) also costs and risks.[5]

Sydney's Stone and Chalk hub shows that many insurers believe that collaboration within the industry can also lead to strong commercial outcomes. The endeavor has been funded by some of Australia's largest financial institutions, with ANZ Banking Group, HSBC, Macquarie Group, Suncorp Bank, Westpac Banking Corp, AMP and Insurance Australia Group announced as foundation corporate partners.[6]

At the same time, many insurers are also scouring the FinTech sector for potential acquisition targets that could help them expand or 'scale up' their business. Last year's purchase of bswift (a private health insurance exchange platform in the US) by Aetna wasn't just about capturing part of the US private health exchange business, it also gave the company unfettered access to bswift's consumer-friendly technologies.[7]

Taking the optimal approach

With so much activity swirling around the FinTech sector, many insurance executives are now starting to reconsider their optimal approach to investing in innovation. Many of the conversations we have with our clients center around finding the right model – or, more often, models – to make the most of their FinTech investments. Unfortunately, there is no cut-and-dry answer.

Most often, the choice of ownership structure comes down to what you are trying to achieve with your investments. Those seeking to create a new customer-interaction process will likely want to exercise tight control over things like customer outcomes and service levels and, as a result, may want to consider an outright purchase of the technology or company (as Aetna did with bswift).

Those looking to tap into a highly technical or niche FinTech innovation, on the other hand, may prefer to select a partnership or outsourcing model that provides access to the new technology without requiring significant up-front development costs or risks. Initiatives that impact the core of the underwriting decision capability, on the other hand, may need to be developed fully in-house or by leveraging a combination of purchases and partnerships.

A multi-strategy approach

Many organisations are using a combination of strategies to maximise their investments and reduce their risk. We are working with one insurer, for example, who is pursuing an M&A strategy to lock down specific technology solutions that support their target operating model; partnerships to improve aspects of their distribution and sales models; and in-house developers to bring new ideas for their core underwriting engine.

At KPMG, we are taking a similar approach to maximise our global network's investments into D&A and FinTech. In 2013, we set up KPMG Capital as an investment vehicle to help our network develop partnerships, incubate and commercialise new ideas and technologies.

At the same time, our individual member firms and practices have also been entering into partnerships and conducting acquisitions to fill specific gaps within their own business areas,

4 http://www.axelspringerplugandplay.com/2014/corporate-partner-program-ergo-insurance-group-axel-springer-plug-play/
5 http://techcrunch.com/2013/04/16/mercedes-benz-bosch-and-hdi-create-new-accelerator-with-startupbootcamp-berlin/
6 http://www.smh.com.au/business/banking-and-finance/craig-dunn-to-chair-fintech-hub-stone-and-chalk-20150303-13tgnk.html
7 http://finance.yahoo.com/news/aetna-aet-acquires-bswift-focuses-202002944.html

for example, KPMG Australia recently purchased SR7, a social media 'listening' firm, and KPMG in the UK recently entered into a partnership with McLaren Applied Technologies. We've also been developing our own unique solutions and platforms in-house – such as KPMG Magna, a financial risk tool, and KPMG Konduct, a customer insight platform.

Our experience suggests that this type of multi-strategy approach may be the best way forward, particularly for national and mid-sized organisations seeking to create a new competitive differentiator through technology enablement.

The reality is that the market is moving quickly and good ideas may emerge from a range of different sources. Those that put all of their investment dollars and efforts into just one or two initiatives – or those that are tied to a specific investment model – may lack the flexibility to adapt to new market changes in the future.

In today's FinTech market, ownership clearly isn't everything.

CONTRIBUTORS

Sam Evans
Global Insurance Deal Advisory Lead
KPMG in the UK
T: +44 20 7694 1326
E: sam.evans@kpmg.co.uk

Sam has significant insurance transaction experience, having worked on deals in many of the major global insurance markets. Sam has worked with KPMG member firms in the UK, Australia, Switzerland and Hong Kong. He currently leads KPMG International's Global Insurance Deal Advisory team.

Martin Blake
Chairman, New South Wales
KPMG Australia
T: +61 2 9335 8316
E: mblake@kpmg.com.au

Martin has over twenty years' experience in managing large transformation programs and developing business strategies for corporations in Australia and Asia. His areas of expertise include business and growth strategies, merger integration and separation, target operating model development, process and organisation design to support large scale transformation programs. In addition to his Chairman role, Martin was recently appointed Head of Insurance for KPMG Australia.

Ralf Baukloh
Partner
KPMG in Germany
T: +49 69 9587 3440
E: rbaukloh@kpmg.com

Ralf joined KPMG in Germany in 2010. He is heading the Financial Services team with a focus on Strategic Advisory as well as Deal Advisory, which he also represents in the insurance sector. Ralf is member of the German Financial Services Leadership team and is the Global Head of M&A for financial services. In addition to that, he is heading the Corporate Development team of KPMG in Germany.