FORSKE

Insurance Strategy

ARE YOU PURSUING AN OPTIMAL MARKET SEGMENT PARTICIPATION STRATEGY?

Richard Hoad
FORSKE STRATEGIC ADVISORY | WWW.FORSKE.COM
AUGUST 2019

Executive Summary

- A proprietary analysis of 66 authorised active UK insurers has been developed mapped against the products they manufacture and distribute. Overlaying this analysis on a market segmentation model provides insight into insurers segment participation strategy.

- This analysis highlights the divergent market participation strategies for insurers, where many have a single segment focus, some have a related segment focus and others have a much broader multi-segment strategy.

- There are various explanations for differing participation strategies, from legacy reasons, to accessing synergies, to related segment expansion. But insurers should consider the potential challenges to their approach as well as the benefits, from the potential risks of segment concentration, to complexity of managing multiple segments, to potential expense inefficiencies of a large group overhead.

- Recent market activity highlights a mix of segment broadening (Vitality, Allianz, AIG, Phoenix) and re-focusing (Standard Life Aberdeen, L&G). Regulatory reforms and economic conditions can be a catalyst for segment choice, but a proactive approach to determining participation strategy should also be taken.

- In taking this proactive approach, insurers should ask some key questions relating to their market segment positioning to optimise value. 1) How does it align to their corporate strategy? 2) What is the rationale that connects the segments they operate in? 3) Are they maximising potential synergies from multi-segment participation? 4) Are multi-segment resource allocation decisions impacting business area value?

Segmenting the Insurance market

This note is primarily based on a proprietary model of authorised[1] insurers (whether the parent company or an entity in their group) in the UK with a product mapping by insurer. In total this list covers 66 insurers ranging from international groups operating in the UK (Zurich, Generali, AIG) to large UK listed firms (Aviva, L&G), to single market segment focused competitors (Rothesay, Hastings) and product focused friendly societies (British, Cirencester).

From this mapping exercise a segmentation model has been developed that splits the insurance sector into 10 segments listed in the table below. Clearly there are differing approaches to segmenting the insurance market, but the segmentation approach used is a logical extension of the product mapping[2].

The table below shows the number of firms active in each of these 10 segments:

[1] It does not cover firms, notably in Asset Management and Distribution & Financial Advice, which do not require insurer authorisation. So, firms such as St James Place (manufacture regulated products), Intrinsic (part of Quilter) and Blackrock are included but firms such as Openwork, Jupiter Asset Management and Columbia Threadneedle would not be.

[2] Further detail on the methodology used is outlined on the final page of this note.

Market Segment	Insurers Active
Life Insurance	28
Pensions & Retirement Income	21
Pensions De-Risking	10
Savings & Investments	26
Life & Pensions Consolidation	6
Health Insurance	9
Distribution & Financial Advice	18
General Insurance – Personal Lines	25
General Insurance – Commercial Lines	19
Asset Management	21

This shows that for example, in the Life Insurance segment there are 28 active participants, in General Insurance Personal Lines there are 25. These will be both segment specialists but also firms active in a number of segments.

The data highlights the competitive nature of some of the market segments purely on number of active firms (rather than a market concentration measure).

Number of Insurers by Active Market Segments

The table below shows the total number of insurers split by the number of market segments they actively participate in.

For example, out of the 66 total insurers in the analysis, 20 are active in 1 of the 10 market segments, 14 firms in 4 segments and 1 firm is active in all 10 market segments.

Active Market Segments	No. of Insurers
1	20
2	19
3	3
4	14
5	4
6	5
7	0
8	0
9	0
10	1
Total	66

The table highlights three key points:

- The majority of insurers (c.60%) are specialists in either 1 or 2 active markets.
- There are a large number (c.21%) who are active in 4 segments.
- Only 1 is active in more than 6 segments, with a presence in all of the 10 segments listed (Aviva).

Strategy by Market Segment

Do some market segments attract increasing specialism than others? The table below provides a breakdown for each market segment the number of insurers active in either only that segment or that segment and one additional.

For example, for Life insurance, 12 (or 43%) of the 28 insurers active in that segment are only active there and at most in one other segment.

Market Segment	1-2 Active Segments
Life Insurance	43% (12/28)
Pensions & Retirement Income	5% (1/21)
Pensions De-Risking	30% (3/10)
Savings & Investments	15% (4/26)
Life & Pensions Consolidation	33% (2/6)
Health Insurance	56% (5/9)
Distribution & Financial Advice	11% (2/18)
General Insurance – Personal Lines	64% (16/25)
General Insurance – Commercial Lines	53% (10/19)
Asset Management	14% (3/21)

High Level of Segment Concentration

Can we rationalise this segment specific specialism? Let's take those segments with high levels of specialism – notably Health Insurance and General Insurance (both Personal and Commercial Lines).

General Insurance Personal Lines differs to a large degree to other segments. While there are functional similarities in the pricing, underwriting and management of risk to a segment such as Life Insurance. There is a different distribution mix with a greater emphasis on direct or PCW sales, which arguably creates greater opportunity for new segment specialist entrants to the market (Hastings and eSure as examples).

General Insurance Commercial Lines has a different commercial customer base and distribution channels to the other segments, requiring specialist skills (for example in underwriting) and differing distribution relationships.

In the majority of cases those firms who are active in General Insurance and in 2 market segments, are unsurprisingly active in Personal Lines and Commercial Lines. Although as some Commercial Lines insurers have shown running a Personal Lines business requires differing capabilities to be successful (brand, marketing, pricing, PCW expertise etc).

For Health Insurers there are again a number of specialisms that don't necessarily relate to other segments. Notably relationships or ownership of medical facilities, corporate distribution and expertise in the healthcare value chain.

There are of course examples in all three of these segments of insurers who are active in multiple other markets (Aviva particularly notable), but the higher concentration in these segments may indicate a more focused strategy could be more advantageous relative to other lower concentration segments.

Medium Level of Segment Concentration

The Life Insurance segment shows c.43% number of firms focused on 1 or 2 market segments.

Out of these 12 firms, 7 are the friendly societies (Holloway, Cirencester, British etc) with the 3 named focusing even more specifically on the Income Protection market staying consistent with their original purpose. Other friendly societies operating in an additional segment include Shepherds Friendly (Savings & Investment), Foresters Friendly (Savings & Investment), Met Friendly (Savings & Investment) and The Exeter (Health).

Other firms in this segment include the recent Life Insurance start up Guardian, Unum with its focus on Group Life and MetLife who closed their wealth management business in 2017 and is now focused on Life Insurance (individual and Group).

AIG stands out with a focus in the UK on Commercial Insurance and a separate Life business entering the segment via acquisition (Ageas UK Protection business and Ellipse) and now growing quickly in this segment.

In summary, the Life Insurance segment medium level of concentration is driven by the large number of specialist friendly societies, with a small number of other segment specialists. However, with the competitive nature of the sector driven by attractive economics (low capital requirements, potential for good returns) it also attracts a number of larger multi-segment players (notably Aegon, L&G) where the strategic logic relative to their other segments may not be clear.

<u>Low Level of Segment Concentration</u>

The stand out segment with a low level of concentration is Pensions & Retirement Income with only 1 specialist firm (Hodge Lifetime). All other firms have a presence in at least two further market segments.

Most of these firms have an understandable presence in Savings & Investments, typically with an ISA, investment bond or other fund investment product.

Logically many of these firms also have an asset management business which complements the asset gathering of the Pensions & Retirement Income and Savings & Investments segments (Aviva, L&G, Prudential).

Building this logic further and it is clear why some move down the value chain to provide Distribution & Financial Advice to customers of their (and others) products (Quilter, Aviva). This rationale can also be extended into the Pensions De-Risking business based on strong asset and liability management capability.

The low level of segment concentration is supported by a strategic rationale that encourages a multi-segment approach into related segments. This has been accelerated particularly following Pensions Freedoms with the growth in DC assets and ISA allowance increases, as asset management capability becomes increasingly important relative to risk pricing and underwriting for annuity products.

<u>Other</u>

The distribution & financial advice and asset management segments understandably also show a low level of concentration, but this is driven predominantly from the inclusion of only authorised insurers. These two segments are then not capturing all of the firms in these segments as noted earlier in this paper.

Distribution strategies

There are also a number of insurers who are active in a segment through distribution of a third-party product. This type of segment participation is not included in the analysis above which uses product manufacture (or equivalent) as the criteria for inclusion.

The most common segment products distributed by insurers are Life Insurance (4 firms) and General Insurance Personal Lines (7 firms).

In the Life Insurance segments the four firms split equally into two groups:

- Affinity providers offering a greater product selection to their affinities. Police Mutual who have partnered with L&G and NFU Mutual with AIG.
- General Insurers who are looking to increase sales to their existing customer base with new products. Direct Line have partnered with AIG and RSA have partnered with Direct Life and Pensions with a panel offer.

In the General Insurance Personal Lines segment:

- Affinity providers – Wesleyan who have a panel offer (Home, Motor etc) and Police Mutual who have partnered with RSA (Home, Motor).
- A broader mix of other providers looking to extend their product offering – Benenden who partner with RSA (Home insurance) and Mapfre (Travel insurance), Phoenix who via SunLife partner with BISL Ltd (an over 50s home insurance panel offer), HSBC who have partnered with Aviva (Home and Travel) and Prudential who have partnered with Churchill (Car and Home).

L&G have recently sold their General Insurance business to Allianz we assume they would retain a distribution agreement to continue to offer General Insurance products to their customers.

Specific Firm Examples

The analysis of firm's participation strategies shows there are 20 who are focused on a single market segment and 1 firm who participates in all segments.

This outlier is Aviva whose composite approach has rationalised a broad market participation strategy, serving a range of customers and distribution channels (direct to consumer, broker, financial adviser, commercial, pension trustees) in what would appear to be a complex business model.

It is not evidently clear the rationale for this approach, apart from a belief they can be competitive in each market. Potentially there is an argument that there is common functional similarity - the pricing, underwriting and management of risk, and the management of liabilities and assets – to support the business logic. Or that the Aviva brand name is strong enough to stretch from direct to consumer car insurance to marine cargo insurance. Another argument could be that a diversified market presence reduces concentration risk and earnings volatility which supports the dividend and reduces capital requirements.

But this rationale needs to be sufficiently robust to outweigh the undoubted complexity of managing a multi-market segment, international business with a large legacy book.

Out of the 20 firms who are focused on a single market segment, there is arguably some commonality of a need for specialist expertise in that business area. Most common single segments include Pension De-risking (underwriting, risk and capital management, investment management), General Insurance Personal Lines (pricing, claims management, marketing, distribution), Income Protection (underwriting, claims), Health Insurance (distribution, broader medical value chain participation), Life & Pensions Consolidation (operational integration, capital management). While this doesn't of course preclude a multi-segment operator to compete successfully in these markets, the expertise required may just allow a specialist to retain a sustainable market share.

Movements into and out of segments are seen as insurer strategies evolve, market dynamics develop, regulations change (such as Pensions Freedoms) or due to long-term economic factors (such as low interest rates). In recent years there has been a number of segment moves, including:

- AIG entered the Life Insurance segment with their acquisition of the Ageas UK protection business and the Ellipse Group Life business. This Life business now sits alongside their Commercial Lines business in the UK.

- Vitality have extended their behavioural incentives model from Life Insurance and Health into the Savings & Investment and Pensions & Retirement Income segments.

- Allianz have deepened their participation in the General Insurance Personal Lines segment adding to their existing Pet Plan business with the acquisition of the LV= and L&G General Insurance businesses.

- L&G in turn have been focusing more on their target segments, making a number of disposals in addition to the GI business and re-positioning in higher growth markets, such as the acquisition of life time mortgage business New Life. They are focused on 5 market segments with only Life insurance an arguable anomaly (but a market they are leaders in) to their focus on asset and liability management.

- Aegon's exit of their bulk annuities business and re-positioning as a platform business, supported by the acquisition of Cofunds. Their Life Insurance business remains an outlier to this strategy.

- Phoenix have acquired a significant new business capability from their acquisitions of Standard Life and Axa Wealth moving them into a hybrid model of Life & Pensions Consolidation with new business capability (Life Insurance, Pensions & Retirement Income, Savings & Investment, Pensions De-Risking).

- Aviva, already a legacy amalgamation of life & pensions businesses, adding to its Life & Pensions Consolidation history with its acquisition of Friends Life (which also include significant new business capability).

These moves reflect themes of segment expansion, re-focusing and deepening segment exposure dependent on specific firm strategy.

Strategic Considerations on Market Participation

The obvious question is why do some insurers choose to operate in multiple market segments and why do others follow a more focused approach. There are a number of considerations that may impact the market participation strategy:

- Related market expansion – there is clearly a strong rationale to operate in connected market segments. The obvious one is asset gathering in Savings & Investment and Pensions & Retirement Income to flow assets through to an asset management business, which in turn can also extend to third party asset management. Aviva and L&G are good examples of this.

- Customer rationale – related to the prior point an insurer might determine a rationale for why a customer may find an advantage in acquiring more than one product or service from them. Aviva have tried to leverage their composite model with the launch of MyAviva to consolidate various policies into a single digital interface.

  However, this rationale to stretch a brand or customer engagement often falls down in practice. For example, cross-selling General Insurance Personal Lines and Life Insurance products is rarely successful as customers often purchase these via differing distribution channels to find the best price/value or to access financial advice.

- Legacy reasons – a firm might be active in market segments as a consequence of prior acquisitions where that business area could have been a non-core part of the firm acquired. This is not a rationale for remaining invested in that market segment, but could be a reason for the presence.

- Start-ups – there are relatively few start-ups in many of the insurance segments, with arguably the most successful coming in General Insurance Personal Lines. For these start-ups a single market segment focus is naturally going to be their initial focus to grow the business.

- Scale – many segments in the insurance market structurally require firms to operate at a certain scale, for example to achieve expense efficiencies, support a regulatory overhead or maintain a strong balance sheet. This may suggest that the sector lends itself to a relatively small number of larger insurers, rather than a proliferation of smaller competitors and by design it could then encourage large insurers to pursue a multi-market segment strategy.

- Diversification – diversification of risks and earnings can provide advantages in a reduction in capital requirements and a smoothing of earnings volatility if the right segment mix is pursued. The diversification argument is often challenged by investors (who can diversify their exposure by investing in other firms), but there can be genuine advantages for an insurer to gain efficiencies.

- International focus – many insurers operating in the UK market are part of larger international groups. As such the UK may not be the segment view they take, but a regional or global market participation view is more important. This would support a potentially inefficient UK presence if with a broader geographic view there is a supportive strategic rationale. For example, AIG has a large General Insurance Commercial Lines business in the UK but has recently entered the Life Insurance segment via acquisition and is growing quickly. These segments have limited, if any, overlap, but from a wider Group perspective it supports their re-focus on life insurance.

There are clearly a number of potential concerns in pursuing a multi-market segment strategy:

- Complexity – the management of differing business lines in fairly diverse market segments can create a level of complexity for the firm that can be difficult to manage. Differences in distribution, marketing, regulatory requirements, product, customer needs, can all create a challenging mix to manage effectively.

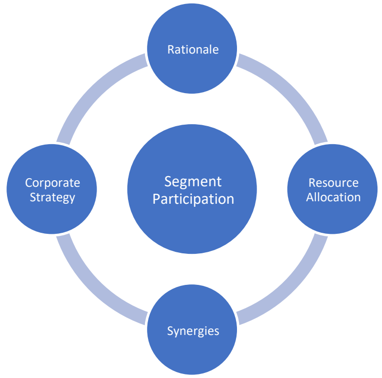
- Cost increases – this complexity could result in an increase in costs, as a Group structure is put on top of the business segments to try and manage the overall business.

- Retaining market segment focus – it may be more challenging to retain a segment focus under a multi-segment model which could result in more focused competitors taking market share. Ensuring sufficient attention is given to each segment in a wider group is important to remain competitive.

- Resource allocation decisions – in any business there are finite resources (capital, resource, capability) to allocate. In a multi-market segment strategy, the allocation decision with competing priorities could result in the under investment in a business area which would be better served as a standalone entity.

What questions should insurers ask to assess their market segment participation strategy?

This analysis highlights a number of questions that insurer management teams should look to address to ensure their market participation strategy is optimising the value the firm generates.



1. *Do you have a clear **CORPORATE STRATEGY** that is supported by the markets you are operating in? If not, should you enter new markets or exit existing markets?*

    - Review your current market segment participation against your strategy. Does the strategy support the segments you are operating in and have you made an active choice to be in those segments, rather than being there for legacy reasons?

    - Are you positioning your business into those segments where you can see a longer-term potential for growth which you can exploit?

    - Are you in segments where you can successfully compete and achieve your market share and profitability objectives?

2. *What is the core **RATIONALE** that supports your market segment participation strategy?*

    - What is the "golden thread" of rationale that supports the segments you currently operate in? Is there a customer, distribution or product rationale, or perhaps you are leveraging expertise across markets?

    - Do you conclude that a focused market participation strategy allows you to compete more effectively? Or that a broader strategy is justified as it serves your customers more effectively?

3. *Are you achieving **SYNERGIES** (expense, capability, capital) by participating in your current market segments or are you destroying value with an inefficient (complex, costly, slow decision making) group structure trying to manage a range of business interests? Would synergies be enhanced by entering new market segments or exiting certain markets?*

    - Are there opportunities to access synergies by expanding into a new market segment and achieving a cost, product or distribution advantage? Could group overheads be spread more efficiently over new segment income streams?

    - Does your current market segment strategy create significant organisational complexity to manage across a range of unrelated segments? Do you feel close enough to your business areas and receive the right information to make decisions that are then executed effectively?

    - Can you quantify the advantages you gain by operating a multi-segment model for example lower capital requirements or better expense efficiencies?

4. *Do you make effective **RESOURCE ALLOCATION** decisions between your market segments to maximise the value achievable in each? Or would each segment be better served with an increased focus?*

    - When you look to allocate resources – capital, capability, time – to certain market segments do these come at a trade-off to not investing in other segments? Could you create more value by exiting that segment and extracting sale proceeds for another owner who may be better positioned to focus on that business? Of is it a case of restructuring your business to more effectively focus on each business area?

Methodology

This note is primarily based on a proprietary list of authorised insurers in the UK (whether the parent company or an entity in their group) mapped against the products they manufacture and distribute.

This consists of 66 insurers, ranging from international groups operating in the UK (Zurich, Generali, AIG) to large UK listed firms (Aviva, L&G), to single market segment focused competitors (Rothesay, Hastings) and product focused friendly societies (Holloway, Cirencester). The segment not included is the Lloyds Insurance Market.

The mapping of products by insurer has informed a market segmentation model that includes the following segments:

- Life Insurance – covering term, income protection, critical illness, 50+, whole of life, funeral plans – distributed either direct to customer, via intermediaries or via corporates.
- Pensions & Retirement Income – covering pensions, annuities, drawdown, equity release, long term care – distributed either direct to customer, via intermediaries or via corporates.
- Pensions De-Risking – providing solutions to corporates to manage the risk in their defined benefit pension schemes, from buy-outs to longevity solutions.
- Savings & Investments – ISAs, investment bonds, cash accounts, share trading, investment funds – distributed either direct to customer or via intermediaries.
- Life & Pensions Consolidators – the acquisitions of in-force business to achieve expense, capital and efficiency savings by consolidating with other in-force business.
- Health Insurance – private health insurance, health cash plans, discretionary health insurance, dental insurance – distributed either direct to customer, via intermediaries or via corporates.
- Distribution & Financial Advice – the platform to facilitate the distribution of financial products (direct or intermediary) or the provision of advice or guidance for the sale of financial products to customers.
- General Insurance Personal Lines – motor, home, landlord, pet, travel, boat insurance etc – distributed either direct to customer, by price comparison websites or via intermediaries (brokers / third parties).
- General Insurance Commercial Lines – employers' liability, public liability, property, motor fleet, D&O, cyber, trade credit etc – distributed either direct to customer or via intermediaries (brokers / third parties).
- Asset Management – the management of assets sourced from either the insurers own customers or third parties. ISA, investment bond, annuities, fund investments or pension products are common vehicles for the direct sourcing of assets.

The analysis has also included consideration of whether the insurer is a product manufacturer or is distributing a third-party product to its customers. Where the insurer is distributing a third-party product it is not included as being active in the market segment for the purposes of this paper.