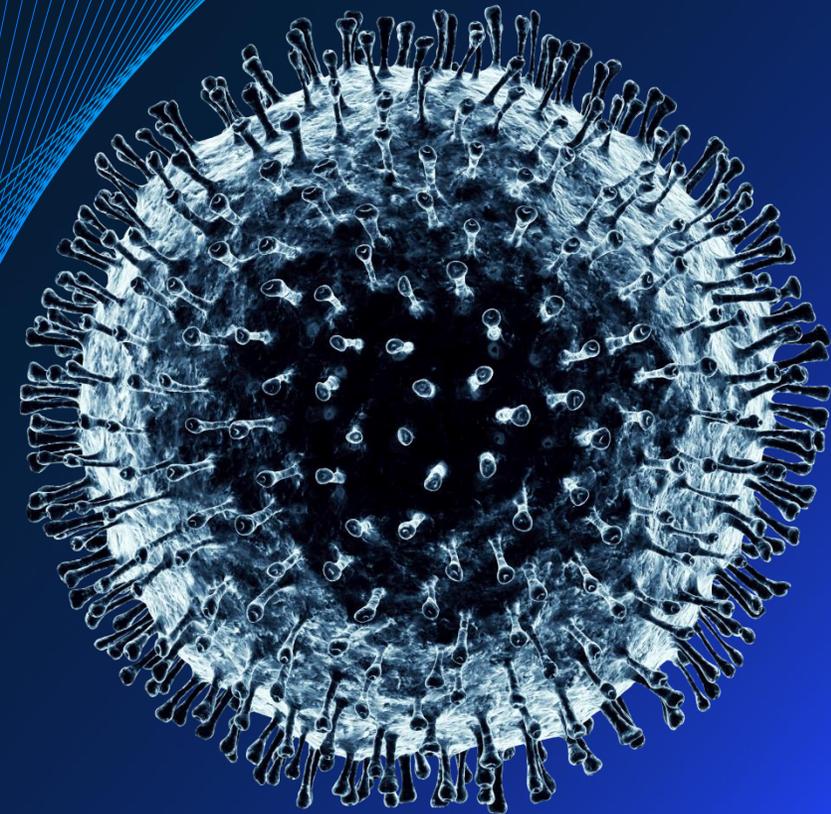


# ACLI 2020: Implications of COVID-19 for NA Life and Annuities

March 15, 2020



**COVID-19 is, first and foremost, a global humanitarian challenge.**

Thousands of health professionals are heroically battling the virus, putting their own lives at risk. Governments and industry are working together to understand and address the challenge, support victims and their families and communities, and search for treatments and a vaccine.

**Companies around the world need to act promptly.**

This document is meant to help senior leaders understand the COVID-19 situation and how it may unfold, and take steps to protect their employees, customers, supply chains and financial results.

# Pandemics as portals to another world

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*Historically, pandemics have forced humans to break with the past and imagine their world anew.*

*This one is no different. It is a portal, a gateway between one world and the next. We can choose to walk through it, dragging the carcasses of our prejudice and hatred, our avarice, our data banks and dead ideas, our dead rivers and smoky skies behind us.*

*Or we can walk through lightly, with little luggage, ready to imagine another world. And ready to fight for it.”*

- Arundhati Roy

# Outline of our discussion

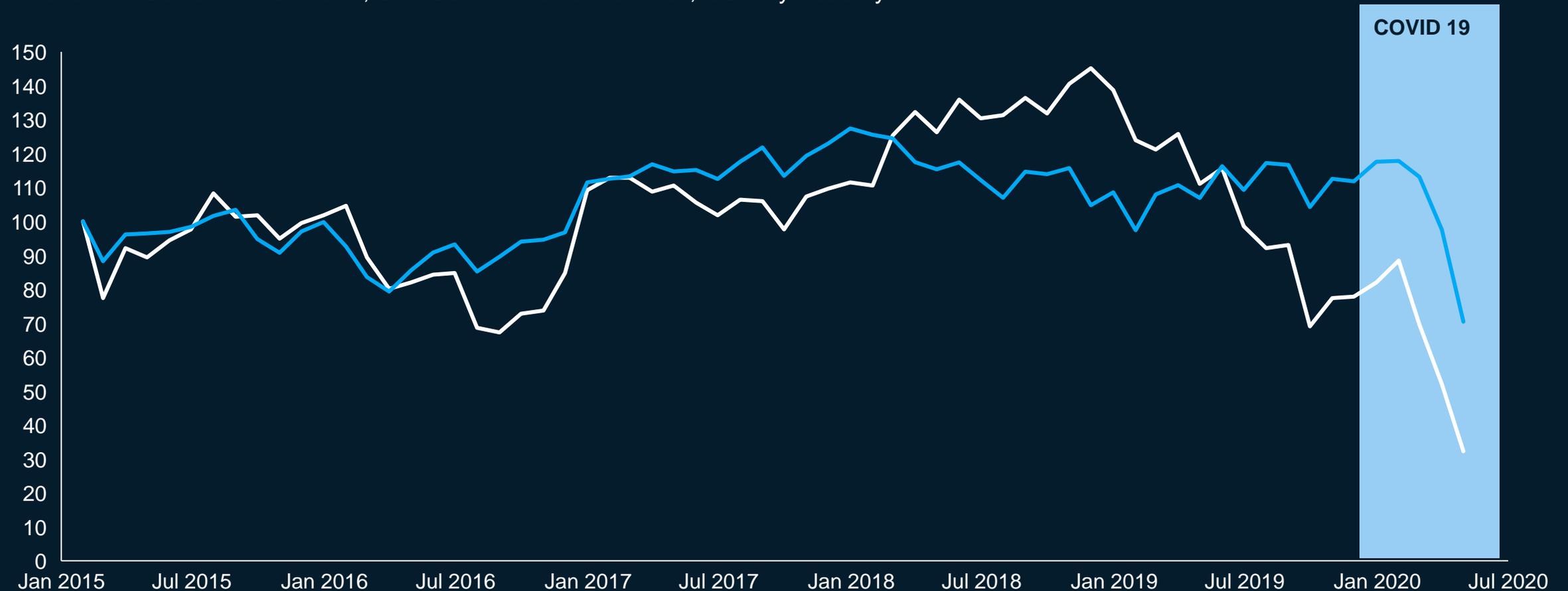
- A** Impact of COVID-19 on life insurers
- B Imperative for product innovation
- C Opportunity to accelerate channel migration
- D Actions related to in-force



# Impact of COVID-19 on U.S. Life Insurers in terms of rate exposure

— US 10y indexed — SNL US indexed

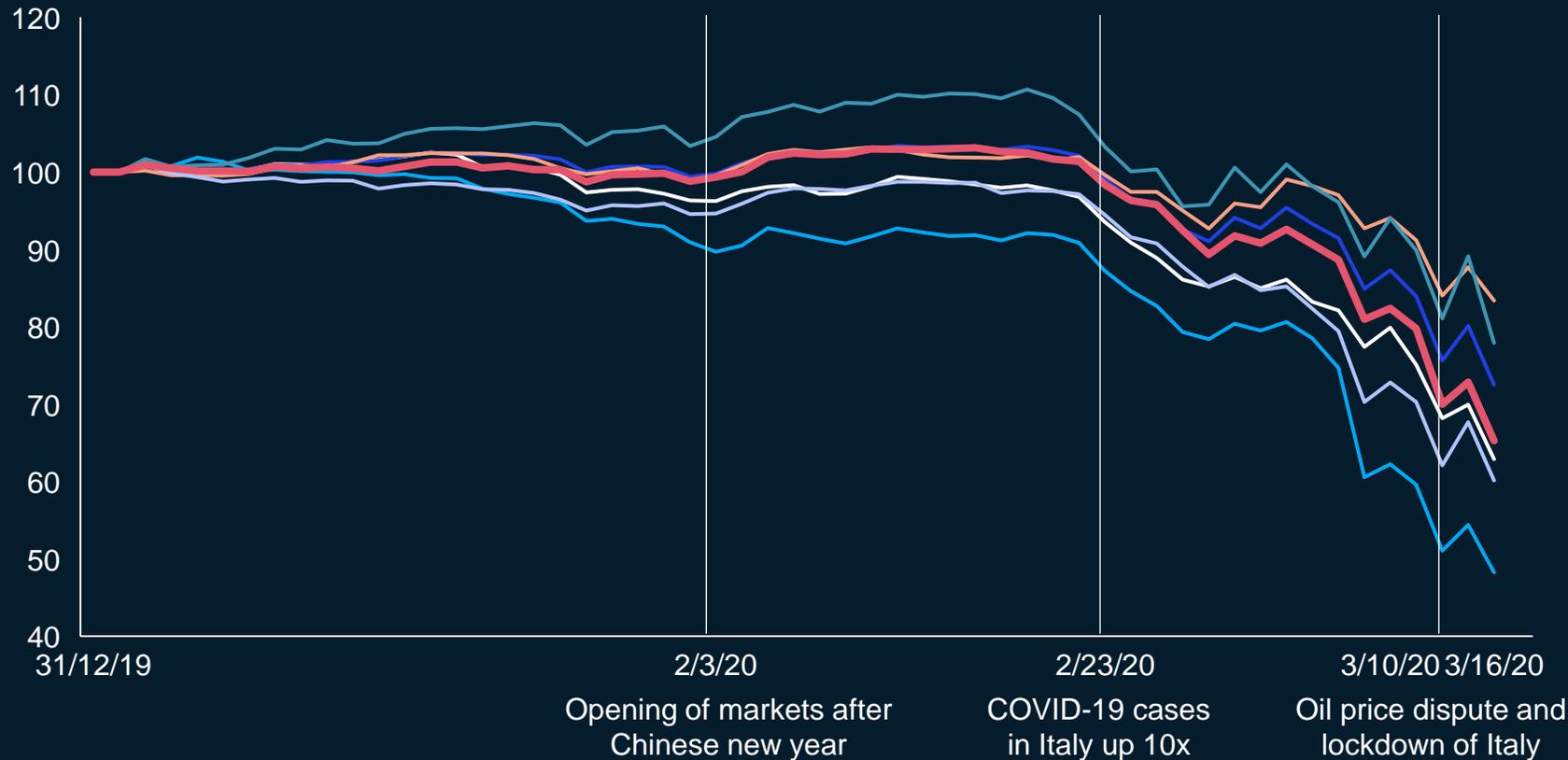
Indexed to 100 as of 12/31/2014, SNL US Life insurance index, US 10 y treasury note



# Insurance has been impacted more than many other sectors

## Selected global sector share prices January-April 2020

Indexed to 100 as of 12/31/2019



Delta, in pp  
12/31/19 vs 3/16/20

Pharma	-16.6
Technology	-22.1
MSCI World	-27.5
<b>MSCI World Insurance Ind.</b>	<b>-34.7</b>
Travel, Transport & Logistics	-37.1
Banking	-39.9
Oil & Gas	-51.8

# North American life and annuities face a multi-pronged challenge

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## Operational disruptions

Potential reduced appetite for higher value policies given economic volatility

Disruption of new business and underwriting processes due to dependence on paper applications and medical underwriting

Inforce operation disruptions (e.g., call centers with performance erosion in the absence of robust remote capabilities)

Cyber exposures due to remote ways of working



## Pricing, product and balance sheet disruptions

Drops in interest rates forcing carriers to adjust new business pricing

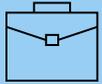
Significant pressure on inforce blocks with rate sensitive guarantees, particularly those written before the Global Financial Crisis

Potential credit migrations leading to further balance sheet challenges (e.g., declining reserve ratios)

Risk of broader instability in financial markets (e.g., disruption of normal money movements)

Possibility of variable annuities with equity linked guarantees breaking their hedges in case of further declines in equity markets

# Navigating these challenges requires a comprehensive response



## Innovate the product portfolio

Shift away from capital intensive, rate-sensitive products with embedded guarantees to more capital efficient products

Accelerate advancement of products that can be priced and underwritten without a medical exam



## Drive channel migration

Promote digital channels for all steps of the value chain (e.g., remote capabilities for advisors, digital payment submission and claims)

Potentially shut down paper forms for portions of certain processes



## Make inforce management a strategic priority

Explore reinsurance, buy-outs and closed block transfers

Consider a broader set of levers (e.g., retention optimization, cross-sell and up-sell, data-driven management of claims)



## Get serious on cost

Adopt practices adopted by restructuring industry to address the fact that industry's cost structure as percent of premium remained unchanged since the crisis

Consider other levers such as zero-based budgeting mindset



## Exploit strength

Take a long-term view and leverage M&A to accelerate fee-based earnings growth or gain scale (providing the carrier is well capitalized or can access relatively inexpensive sources of capital)

Explore opportunities to partner with private capital



## Upgrade talent and shift ways of working

Go beyond hiring within the industry and extend to hiring scarce digital and analytical talent

Reskill employees to operate in a more digital world and embed new ways of working including remote deployment of agile practices



## Accelerate the move to fee-based earnings

Accelerate execution of inflight initiatives

Reassess portfolios to determine whether to invest in logical adjacencies (organically or inorganically)

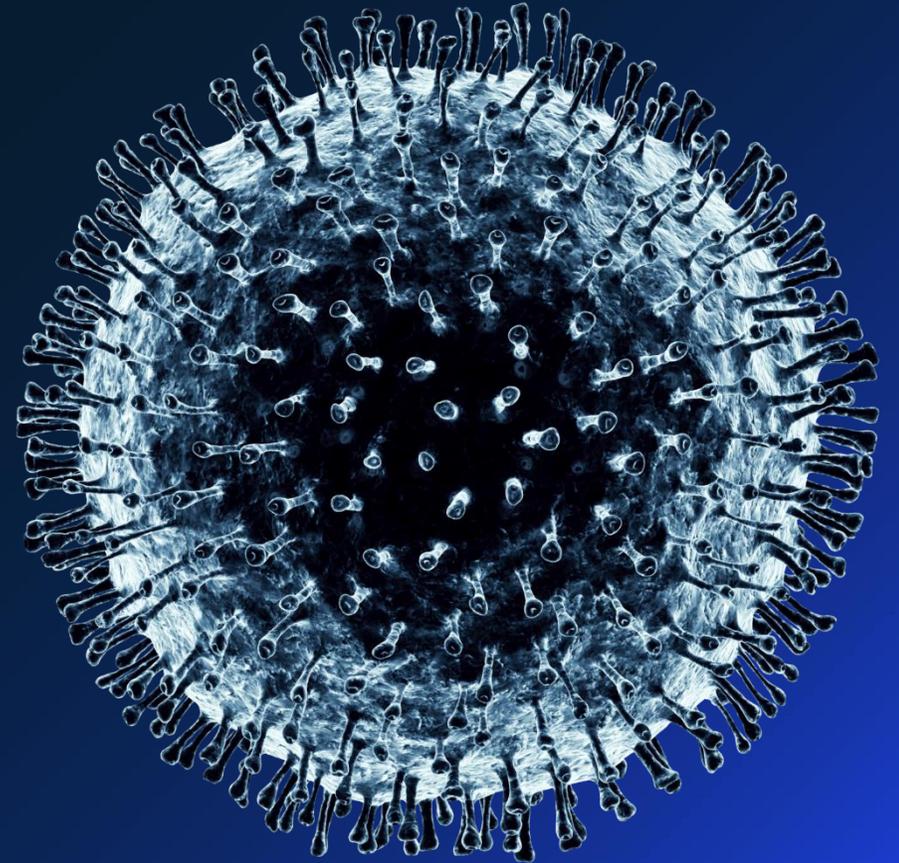
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# COVID-19 is driving renewed product innovation

- 1** Carriers that rapidly introduced new products increased market share during periods of high market volatility
- 2** Sustained, low interest rate environments globally **require insurers to innovate** as traditional guaranteed products are less viable
- 3** Carriers in countries with persistent low interest rates have **aggressively pivoted their source of risk** exposure or exited the market
- 4** Lessons in **agile product development** from the technology industry can be appropriated by the life insurance and annuities industry

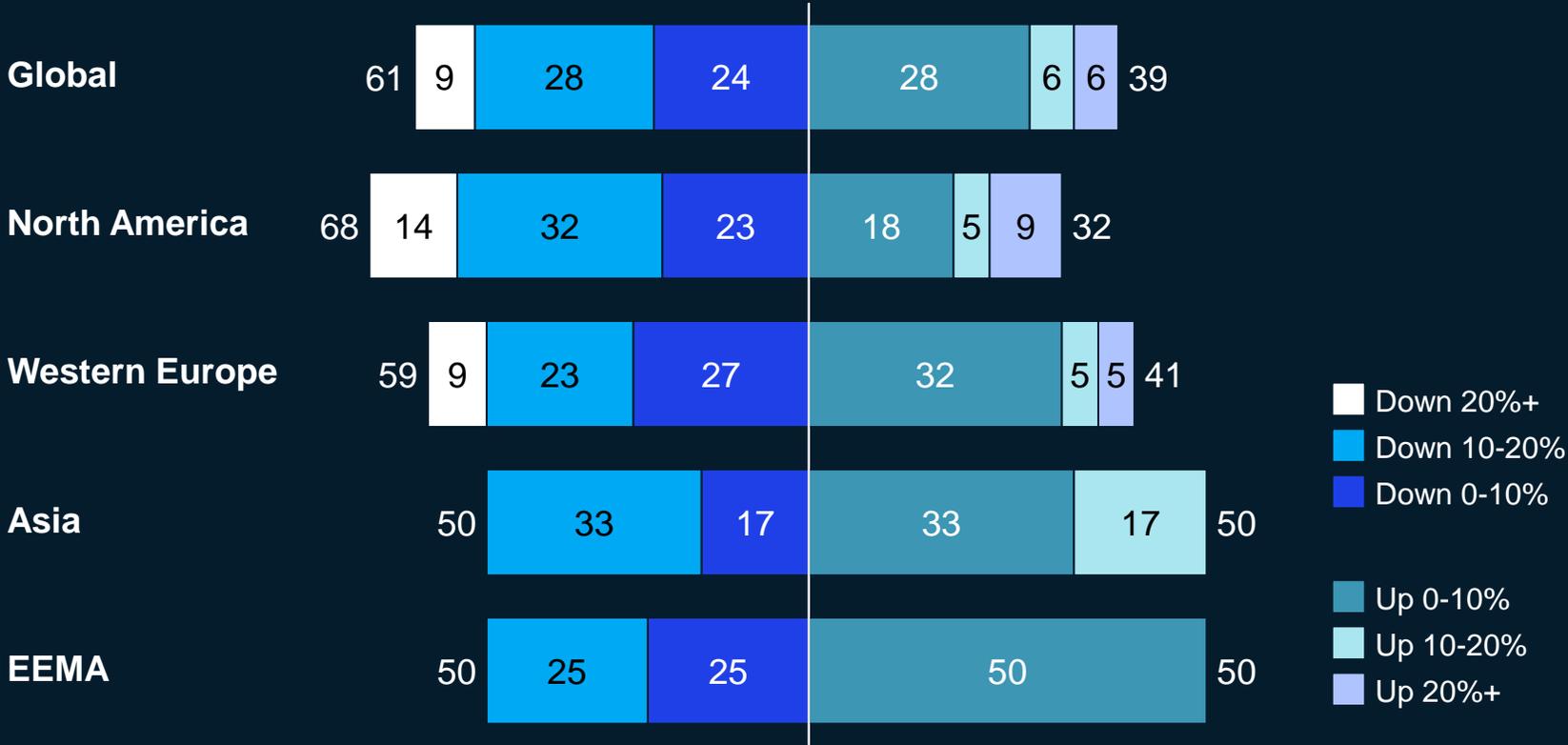


# A period of volatility?

Although 61% of McKinsey Insurance partners expect L&H new sales to decline due to COVID-19, close to 40% see a potential uptick in sales

Source: Internal McKinsey poll data as of Mar 13, 2020, n = 54

Share of respondents by expectation for L&H new business sales in 2020  
% of respondents



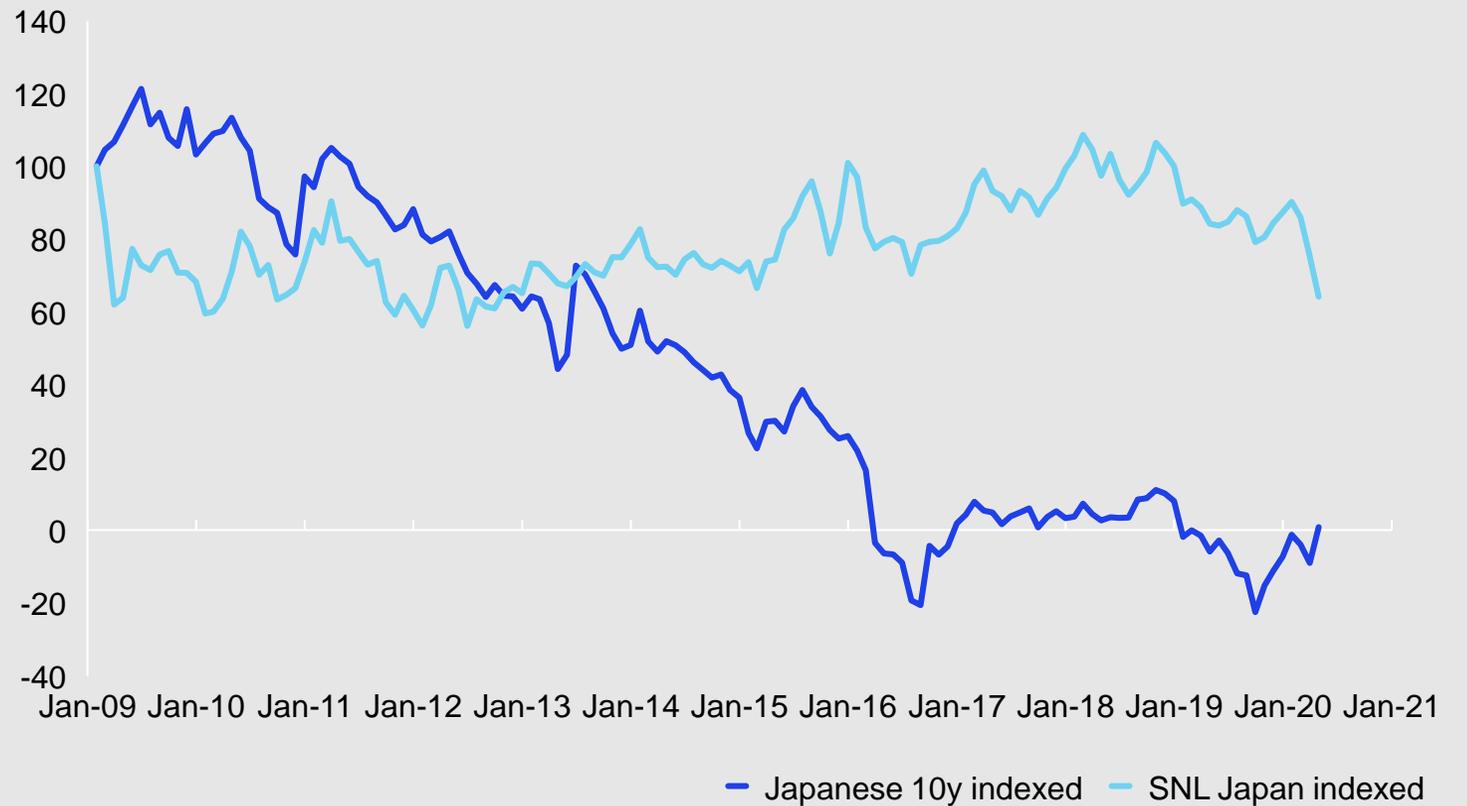
**Lessons from Japan:**  
Carriers have long faced ongoing low-rates and managed to create value for shareholders, while “untethering” from the 10-year rate



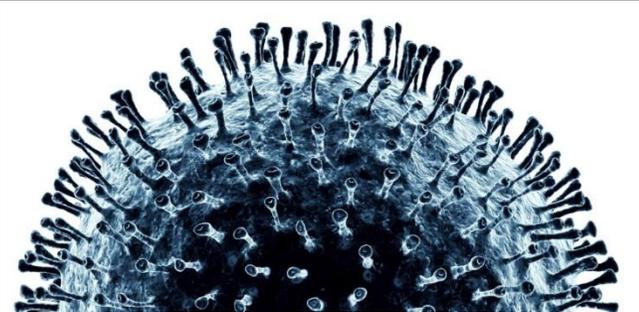
Source: SNL

### Carriers can still perform when rates are at zero

Indexed to 100 as of 2/28/2009, SNL Japan Life insurance index, Japanese 10 y bond yield



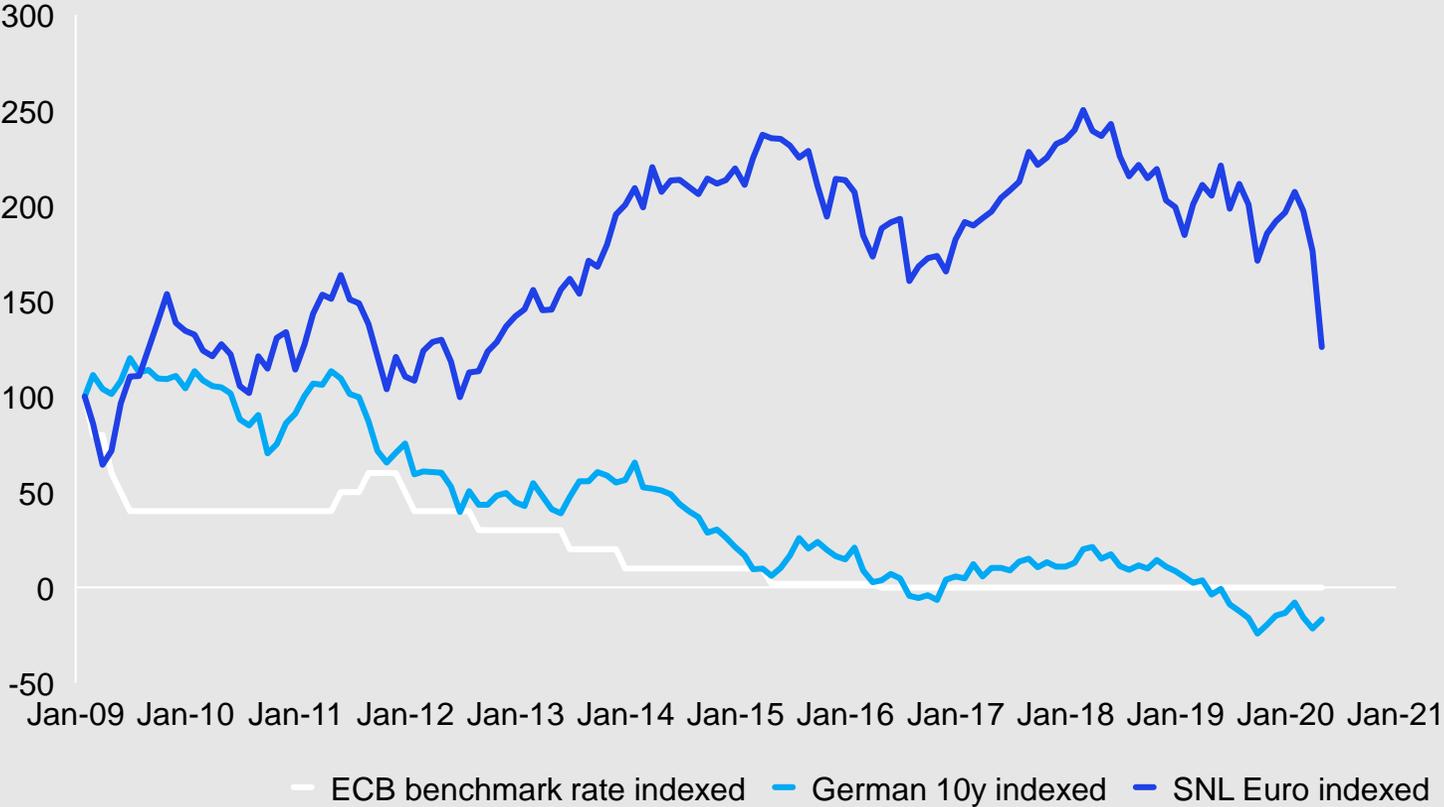
# Lessons from Europe: European carriers have aggressively pivoted their source of risk in the past decade



Source: SNL

## Carriers can still perform when rates are at zero

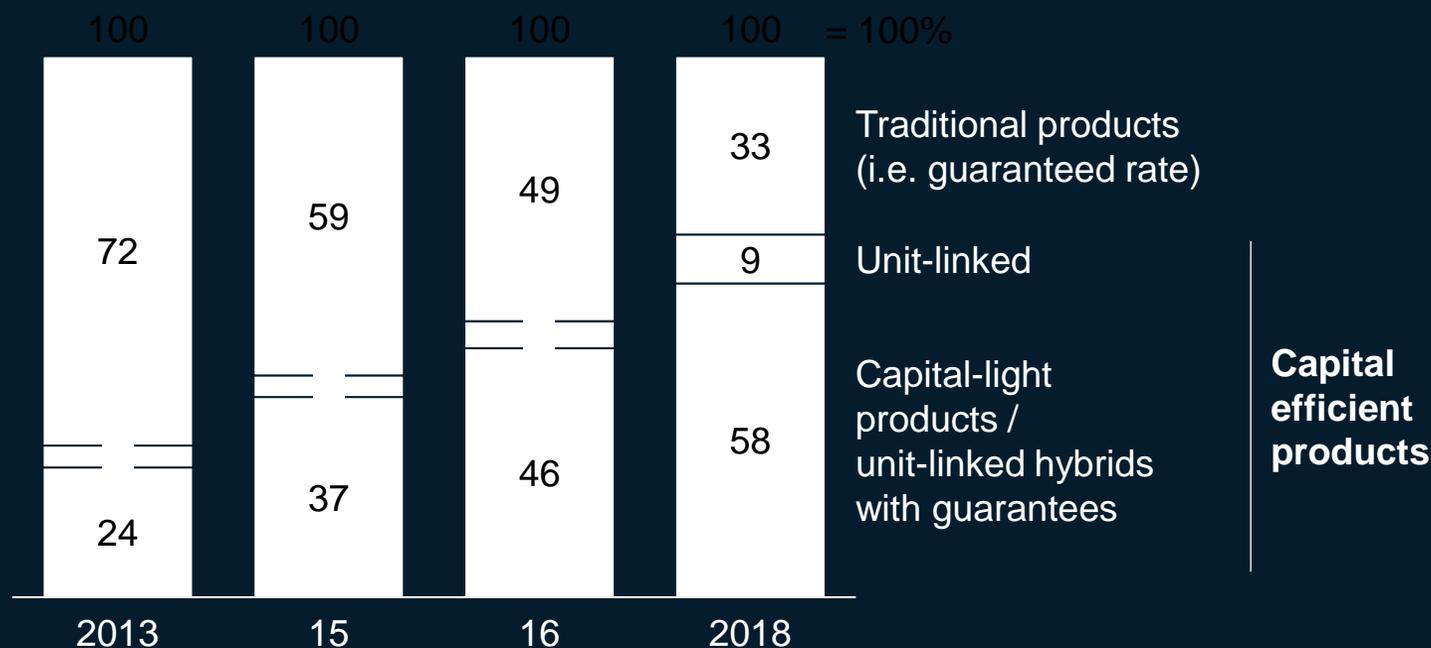
Indexed to 100 as of 12/31/2008, SNL EU Life insurance index, ECB benchmark rate, German 10 y bond yield



# In Germany, carriers shifted to selling capital efficient and disability products

**Sales of capital efficient products increased from ~28 to ~67%**

Share of new business sales<sup>1</sup> by product category, %



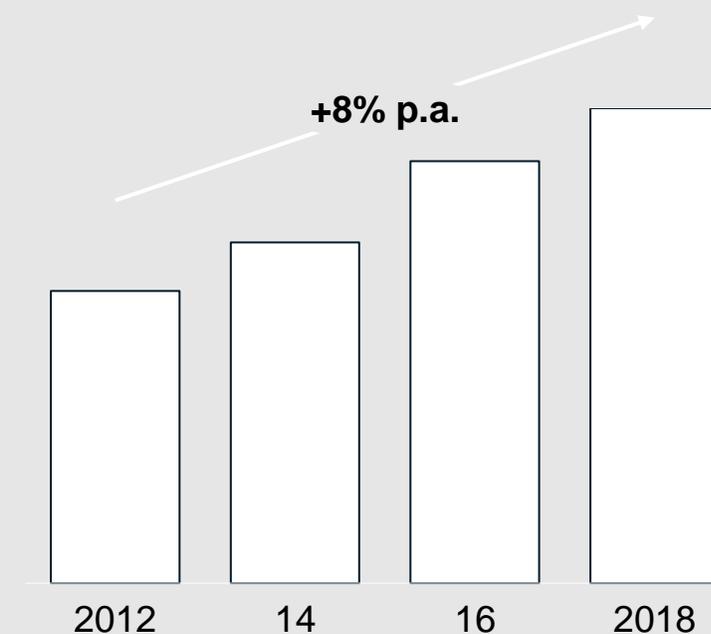
1. New business sales defined in terms of APE: Annualized Premium Equivalent
2. Traditional products with capital or rate guarantee
3. Fixed exchange rate used: EUR/USD of 1.11 as of Dec 2019

Source: Corporate disclosures, expert interviews



**German disability market has grown by 8% p.a.**

Disability insurance Sales<sup>3</sup>, USD Bn<sup>4</sup>



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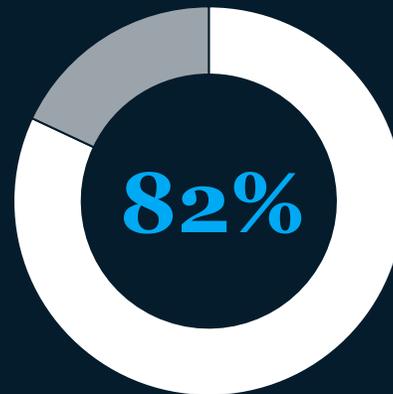
## How to move quickly: Lessons in agile product development can be appropriated by the life insurance industry



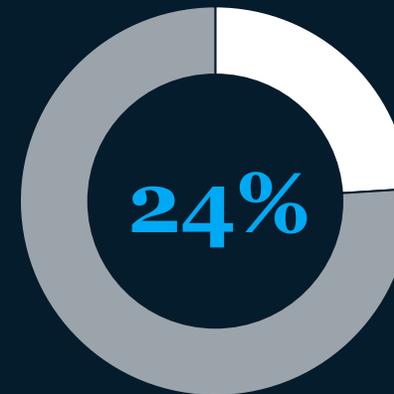
Source: Society of Actuaries, Understanding the Product Development Process of Life Insurance and Annuity Companies (December 2017)

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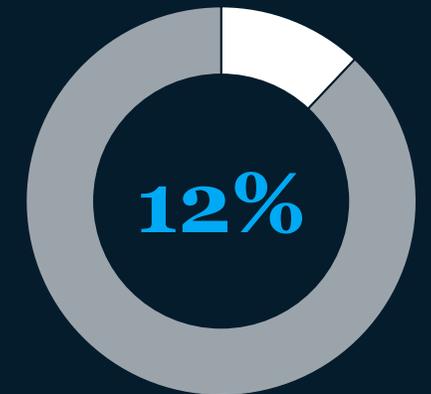
## Of life and annuities senior management surveyed ...



Believe product development is a core competency



Do not have a defined product development strategy



Believe they have a process that delivers strong product innovation

# Five steps of product re-imagination



## Assess

Assess portfolio and identify risks



## Aspire

Create vision for new product themes



## Design

Stand up product team to translate ideas into products



## Develop

Build and implement new products



## Launch

Launch new products and train salesforce



# The McKinsey Innovation Quotient can help test your innovation practices across the “Eight Essentials” of Innovation

<b>Vision and strategy</b>		<b>Aspire</b>	Do you accept innovation-led growth as absolutely critical, and do you have cascaded targets that reflect this?
		<b>Choose</b>	Do you invest in a coherent, time-risk balanced portfolio of initiatives that are resourced to win?
<b>New, bigger, and better ideas</b>		<b>Discover</b>	Do you have actionable and differentiated business, market and technology insights that translate into winning value propositions?
		<b>Evolve</b>	Do you create new business models that provide defensible, robust and scalable profit sources?
<b>Fast and effective scale-up</b>		<b>Accelerate</b>	Do you beat the competition with fast and effective development and launch of innovations?
		<b>Scale</b>	Do you launch innovations in the relevant markets and segments at the right magnitude?
<b>Mobilized organization and culture</b>		<b>Extend</b>	Do you win by creating and capitalizing on external networks?
		<b>Mobilize</b>	Are your people motivated, rewarded and organized to repeatedly innovate?

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# COVID-19 and the associated social distancing policies have significantly changed consumer behavior



The remote working population has increased from ~3% to ~88%



Downstream data consumption has surged by ~2X



10% Increase in online sales



~60% of US consumers believe they need to be very careful with how they spend money<sup>1</sup>



45% Decrease in foot traffic in downtown NYC



~90% of US consumers think it will take 2+ month to return to a normal routine<sup>1</sup>

1. Source: McKinsey & Company COVID-19 US Consumer Pulse 3/23-3/29/2020 N=1,119 matched & weighted to US gen pop 18+ years based on American Community Survey 2016 of the U.S. Census Bureau. Preliminary insights, based on latest available weekly data – to be refreshed weekly

# This change in behavior is deeply impacting insurance distribution



## Tailwinds

Greater public understanding and emphasis on the importance of protection products, resulting in increased customer demand

Increasing, and in many ways forced, adoption of digital channels across all groups and generations of customers

“Burning platform” for strategic investments in distribution infrastructure, especially around digital

Loosening requirements and regulations related to product distribution in order to limit in-person interactions

Opportunity to gain market share if this crisis follows the 08/09 pattern of significant money movement



## Headwinds

Nervous and frightened customer base who may be experiencing health concerns, or significant personal or financial loss

Clunky customer journeys that are far too manual, with products that require in-person interactions to complete (e.g., physical signatures, medical examinations, nurse visits)

Agency force too reliant on in-person interactions, with limited technology skills, and traditionally too slow to adopt digital tools and new ways of working

Carrier-agent interaction model that also relies on in-person meetings and conferences, with an incentive structure that needs to be updated to optimize the current operating environment

Limited robust digital solutions for both customers and agents in place in the marketplace

# Addressing these challenges requires action across five key areas



## Customer experience



## Salesforce management



## Digital



## Data and analytics



## Product focus

### Immediate response

**Proactively reach out** to customers with empathy

**Provide relief on policy payments** (e.g. grace period for renewals, short term payment extensions)

**Shift unused capacity** to support customer demand

**Stabilize agent/agency finances** (e.g., advance commission payouts)

**Push eLearning on remote sales** techniques

**Move to remote wholesaler model**

**Set up remote work process and tools** (e.g., Zoom) and update compliance policies

**Identify customers likely to lapse** given the crisis and increase proactive outreach

**Identify products that may pose undue risk** in this environment or which have increased relevance and communicate desired product shift changes to field

### Next 2-3 months

**Radically rethink customer journeys** based on increased comfort with remote and digital interactions

**Set up separate salesforce designed for remote and digital** customer outreach and relationships

**Focus on teaming models** to increase productivity and enhance resiliency

**Automate and digitize essential distribution touchpoints** to address rising demand (e.g., e-signature, onboarding and approvals, application submission)

**Build out a sophisticated lead generation engine** to provide a stop gap for lack of offline leads, leveraging digital mkt, SEO/SEM, etc to increase inbound lead generation

**Take advantage of rising demand for data and analytics** insights to extend adoption across salesforce

**Update incentives to change desired product mix**

**Respond to revisions in protection product distribution** regulations given changing environment and need for rapid disbursement

# Carriers are acting to address immediate needs



## Customer experience

Established “hot lines” for COVID-19 related questions (e.g., travel, health, advisory)

Delayed premium payments and extended insurance coverage to include COVID-19 cases



## Salesforce management

Created a help package to sustain agencies, branches and points of sale during the lockdown period

Initiated digital sales training and recruiting activities



## Digital

Promoted the availability of alternative channels for both servicing and sales

Switched agents and operations to video customer service



## Data and analytics

Leveraged technology and social media for claim management

Ensured technology infrastructure allows remote ways of working



## Product focus

Suspended sale of certain products (e.g., travel policies, business interruption)



# Beyond the immediate response, carriers can differentiate themselves through bold actions



**Simplified customer services** including claim management through remote channels

**Offered subsidy benefits and increased coverage** for COVID-related cases

**Supported agency** through **relaxing performance requirements**, offering financing and ensuring digital engagement

**Digitized** critical day-to-day **activities** through launching **online marketing campaigns**, **eliminating physical requirements**, initiating **digital sales trainings** and **recruiting**



**Provided dedicated insurance advice** on COVID-related emergencies, educated customers through dedicated health portal

**Suspended payment reminder** actions, and offered to **delay payment** of premiums

**Promoted** a complete list of **sales and services activities** available from remote, leveraged digital channels to **connect customers with agents**

**Provided cash support** to sustain Tied Agents activity and established smart working infrastructure for all employees



# Critical actions to address the current distribution environment

## Customer experience



**Revise communication materials** to be more helpful, empathetic, and instructive in current environment, and plan for sustained marketing effectiveness through COVID crisis

**Assess and launch financial relief efforts** where relevant (e.g., deferrals, suspension, no withdrawal penalties)

**Identify specific customer programs to navigate current interaction model** to limit strain on agent network (e.g., e-learning)

**Prioritize critical customer journeys to address**, assess feasibility, and develop execution roadmap

## Salesforce management



**Analyze needs of agent network and identify those in immediate need of financial and operational support** (e.g., comp advances)

**Stand up pilot for “teaming” sales approach**, integrating internals/hybrid and field salesforces with common goals and targets

**Stand-up training and upskilling sessions** and scale through peer-learning to **improve remote selling skills**

**Develop set of remote focused performance** dashboards and a process for management to monitor and action on results

## Data and analytics



**Roll out and operationalize data and analytics insights at scale** to take advantage of critical adoption period

**Assess high-risk data gaps and determine short-term fixes** via analytics and external data integration

**Streamline current analytics-focused retention and lead generation efforts** through expert coaching and longer-term planning

## Digital



**Help deploy and operationalize essential sales tools in sales teams immediately** (e.g., Zoom, digital research, CRM)

**Prioritize distribution touchpoints for automation** (e.g., e-signature, onboarding and approvals, application submission) and build roadmap for vendor selection, backlog build, and execution

**Launch direct digital offers to customers** that move them toward remote channels and streamlined products

## Product focus



**Assess and double down on the most important “signature” and “crisis specific” product features**

**Create near-term strategy to take advantage of regulations** aimed at streamlining protection product distribution

**Prioritize product portfolio and matching incentives** to suite remote distribution and economics in current low interest rate environment

# Allianz acted on multiple fronts and in multiple regions to respond to COVID-19 challenges



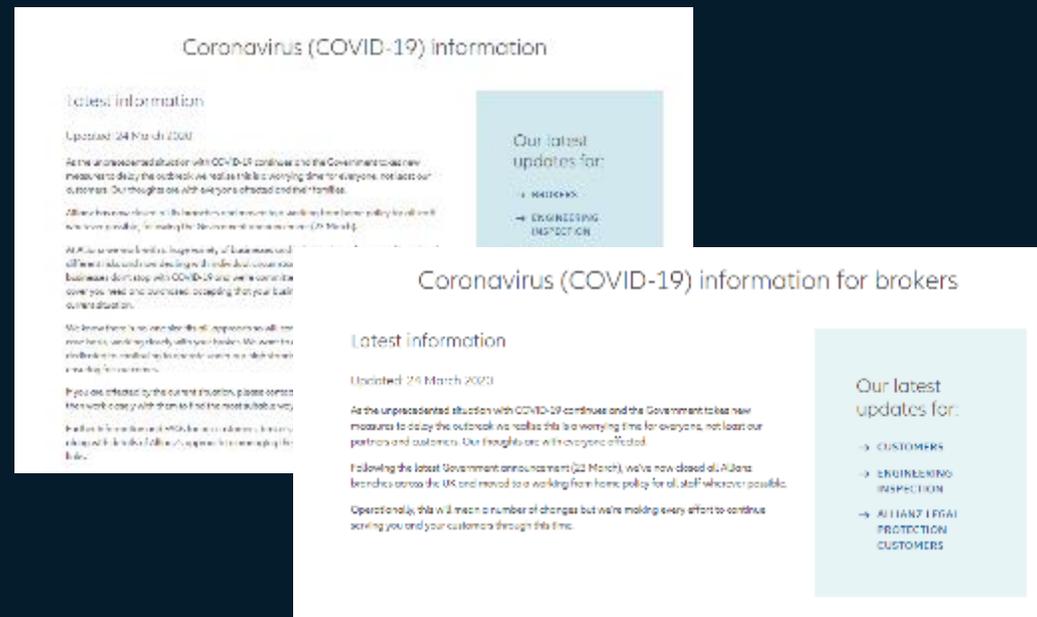
## Agent and Agency Support

Provided cash support to sustain Tied Agents activity

Advertised digital channels to connect with agents

Established smart working for all employees

Created “COVID-19” task-force to monitor situation and respond single-handedly



## Customer and Community Support

### Customer Care

Provided complete list of services available from remote

Actions to support clients living in lockdown areas

Suspended payment reminder actions for all products

Extended motor vehicle policies and offered to delay payment of premiums

Established dedicated portal for Health clients and general public with updates about COVID-19

Provided dedicated advice on how to use insurance services in the COVID-19 emergency

### Community Support

Donation of oxygen and other medical equipment for new intensive care units in Milan

Set up an emergency response fund in China to fight against the epidemic



# AIA took a comprehensive approach to its response in China



## Distribution partner support

- Relaxed performance requirements
- Provided financing arrangements and extended existing ones
- Promoted digital engagement across intermediaries

## Agency Support

### New Initiatives on Recruitment, Retention and Customer Engagement

<b>Sales</b>	Online customer engagement programs Online product promotion campaigns Enhanced Instant Buy sales portal enabling Air Sign remote signature solution and e-payment
<b>Recruitment</b>	Online recruitment activities End-to-end online process for selection, interview and contracting
<b>Agency Management</b>	Live online morning meetings Online training and coaching Special retention and caring programs

## Customer and Community Support

### Customer Care

- Simplified and convenient claims service
- Extra coverage and special case management services
- Special subsidy benefit for eligible customers

### Community Support

- Complimentary one-off lump sum death and disability benefit for eligible medical workers
- Donation of medical supplies to Hubei Province
- Donation to The Amity Foundation and WeDoctor helping people in need



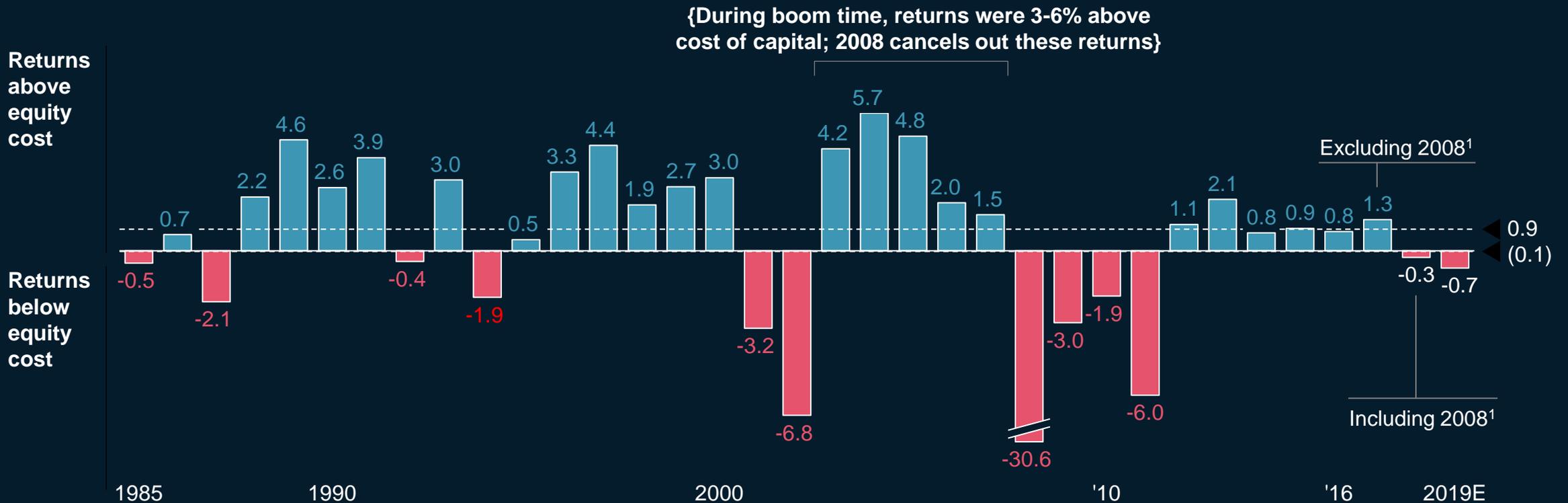
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# Returns have hovered ~1% above cost since the financial crisis

## US Life industry performance (1985-2019): Returns in excess of capital cost



1. Average from 1985 – 2019
2. ROS = statutory net income (including realized capital gains) divided by average capital and surplus; Cost of capital estimated by calculating industry beta for 15 representative life insurance companies and utilizing capital asset pricing model (CAPM). Due to exclusion of mutual companies from set used to calculate industry cost of capital, it is likely that industry cost of capital is overstated and excess returns have been higher
3. 2019 represents annualized 2019 9months data

# Typical challenges with in-force management actions

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## Why it is challenging to act on inforce

*No one owns inforce... or has any incentive to act*

*There is a risk of "backlash" from customers, distributors and regulators*

*Lots of ideas and things to do... where should we start?*

*Terms & conditions are largely defined at inception. Degrees of freedom are limited.*



## What can be done?

Creating a cross-functional process – that drives the process across all impacted functions and clearly articulates trade-offs

Consumer and distributor reactions will need to be taken into account, but carriers who have taken inforce actions have been able to avoid major push-back

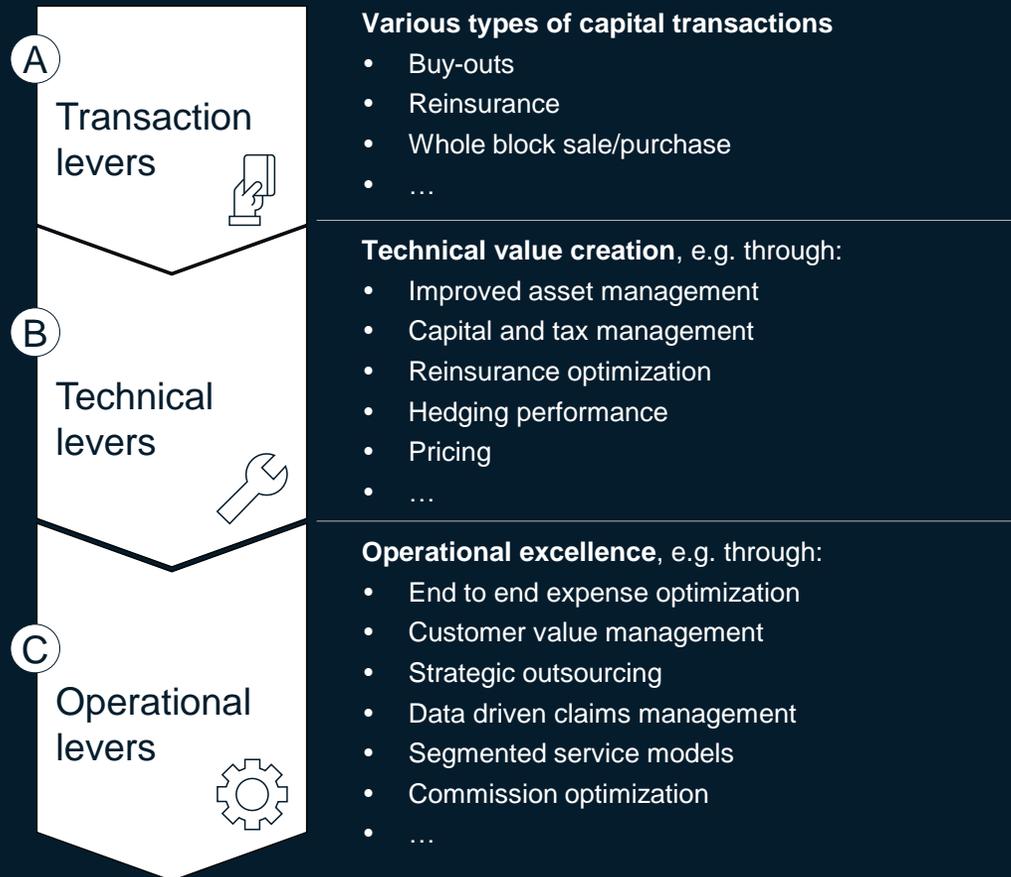
Leveraging an exhaustive list of levers, and quickly prioritize (80/20) based on the structure of the book and contracts

Within contracts, there is often substantial room to adjust and improve inforce economics. Given the volume, even small changes have major impact

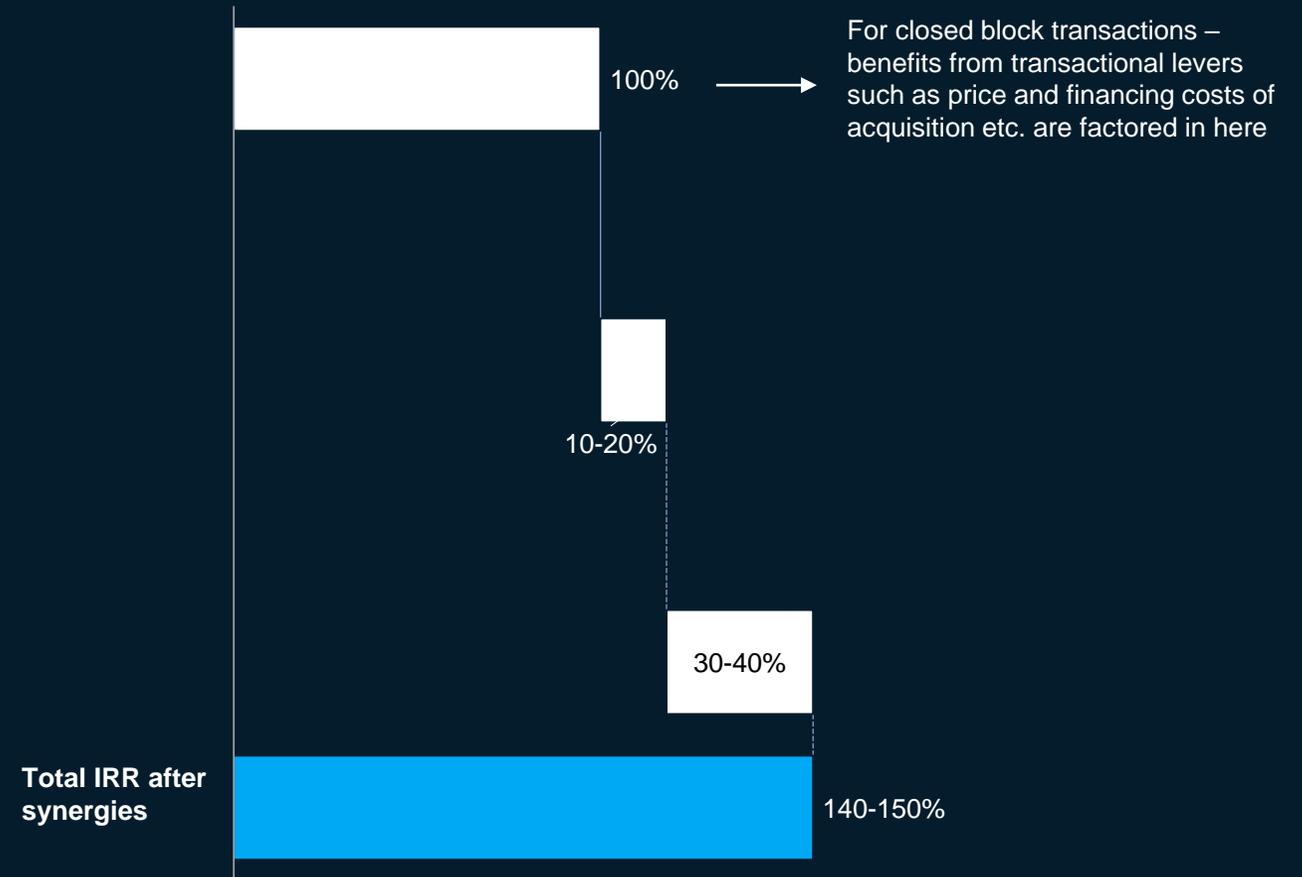
# There are 3 main value drivers behind effective inforce management

The applicability and impact of levers depend upon the type of inforce manager – e.g. closed book aggregator vs. insurance carriers managing their own books

## Value driver and non-exhaustive description of levers



## IRR (Percent)<sup>1</sup>



1. Based on real cases and transactions

# What is the value of the in-force book, what segments of it are under- vs. over-performing and what is the financial outlook?

■ Details follow

## Considerations

### Portfolio segmentation

Identify segments of in-force book at a granular level (e.g., vintages, product categories, channels based available data granularity)

Consider balance sheet and P&L items (e.g., reserves, GPW, guarantee level, number of policies, capital consumption and productivity, profit contribution) of each segment to classify based on long-term profitability (e.g. red, yellow, green)

### Profitability driver analyses

Conduct analyses on each segment to understand the impact of different value drivers

- Profitability by earning source (i.e., technical margins, investments, loads)
- Cash generation profile
- Capital consumption with profit contribution
- Long-term cost loadings by product type
- External expectations (e.g., customers, cap. market/rating agencies, regulator)

### Scenario analyses

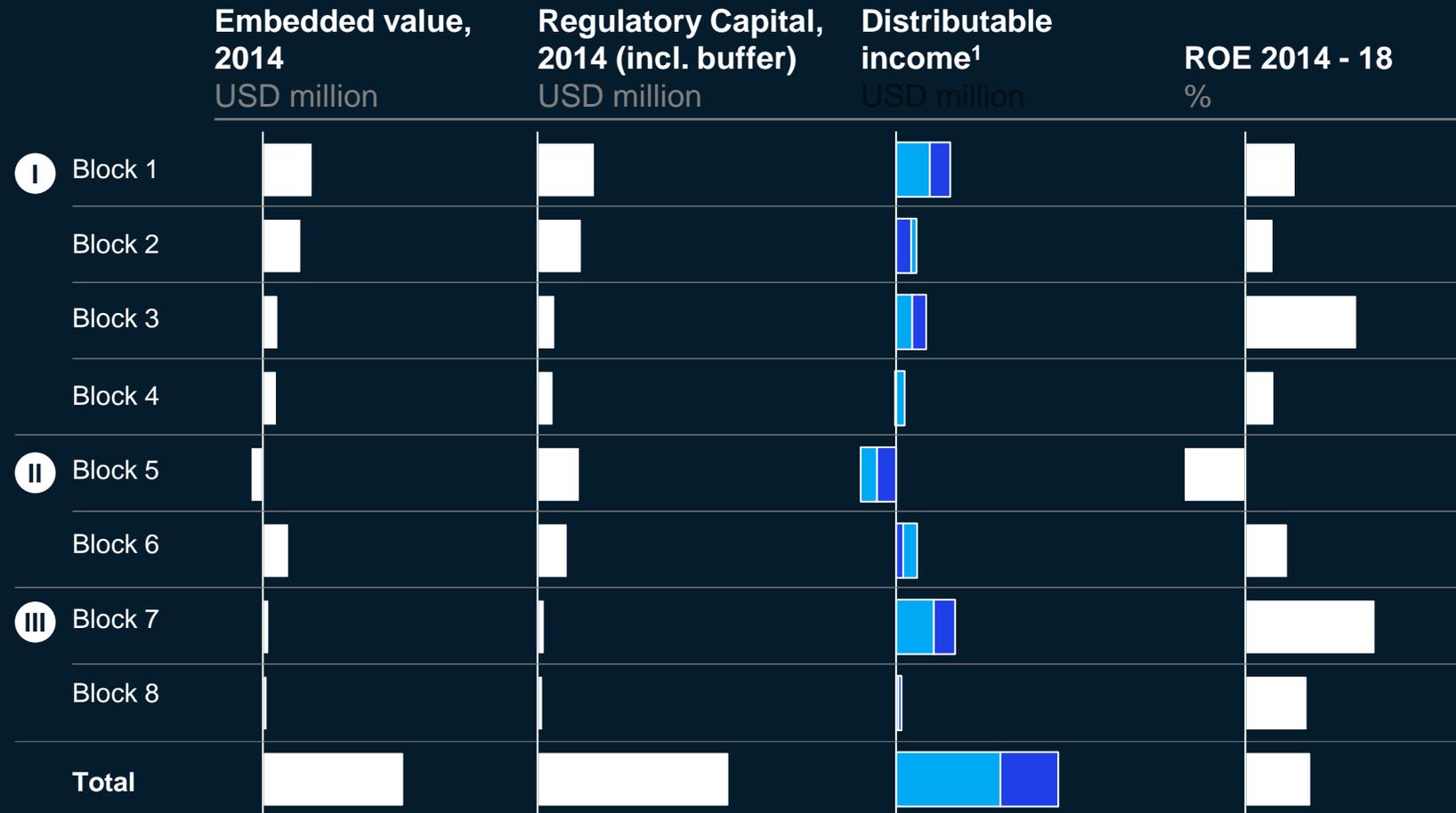
Develop a few economic and actuarial scenarios to understand segments' long-term profitability

Conduct qualitative scenario-based analyses to understand future value, cash generation and capital consumption under multiple scenarios

# Example of segmentation and hypothesis-building

Disguised example

5 years 2014 - 18  
5 years 2019 - 23

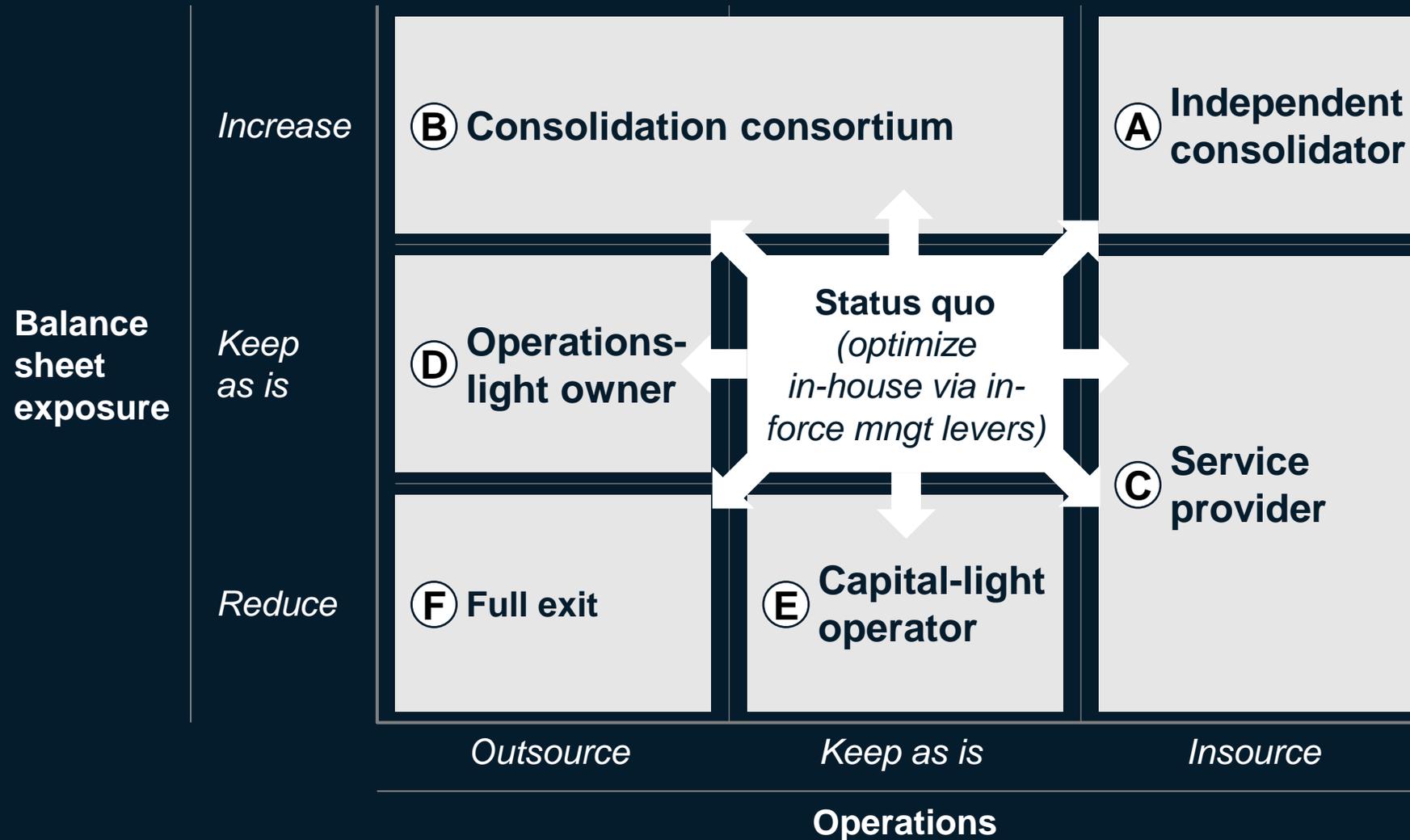


## Key messages

- I Block 1 is comprised of accumulation products and therefore binds significant regulatory capital at low returns. As book runs off, the release of this regulatory capital generates substantial distributable income
- II Block 5 has negative embedded value. This is due to the fact that the block has high future payouts and higher expected claims than estimated in the past. The regulatory capital is expected not to compensate this, resulting in negative distributable income and returns
- III Block 7 binds relatively little capital but generates 30% of the portfolio's distributable income over the next 10 years. This is due to the high percentage of policy loans in this block, which guarantee a relatively high margin and income stream.

<sup>1</sup> Pre-tax and non-technical adjustments

# Depending on desired balance sheet exposure and operating model, carriers choose different strategic postures



# Example: Advanced analytics models are highly effective at identifying policyholders who are willing to switch policies

Using advanced analytics model increased targeting of policyholders willing to switch by ~3.5x



The model incorporates 11 variables most effective in predicting switches to another policy

X Order of statistically significant difference

	Variable <sup>1</sup>	Explanation
Products	1 Rider/no rider sign	Easy to switch policies when the customer has had a rider
	2 Fixed-term rider sign	Easy to switch policies when the customer has had a fixed-term rider
	3 Life Ins._Lifetime healthcare N	Hard to switch policies when the customer owns a lifetime healthcare policy
	4 Life Ins._Yrs./months passed	Easy to switch policies when the customer has owned the life ins. policy for a longer time
	6 Monthly conversion P	Easy to switch policies with higher monthly conversion premiums
Customer	8 Owned S	Easy to switch policies with lower owned S
	5 Years remaining on policy	Easy to switch policies when the customer has more years left on the policy
	7 Policy holder's age	Easy to switch policies when the customer is younger (50-55 yrs.)
	9 Time to deposit	Easy to switch policies with one year or less to deposit date
	10 Avg. family member age	Easy to switch policies when the avg. family member's age is higher
	11 Life Ins._Yrs./months passed	Easy to switch policies when the customer has owned the life ins. policy for a longer time

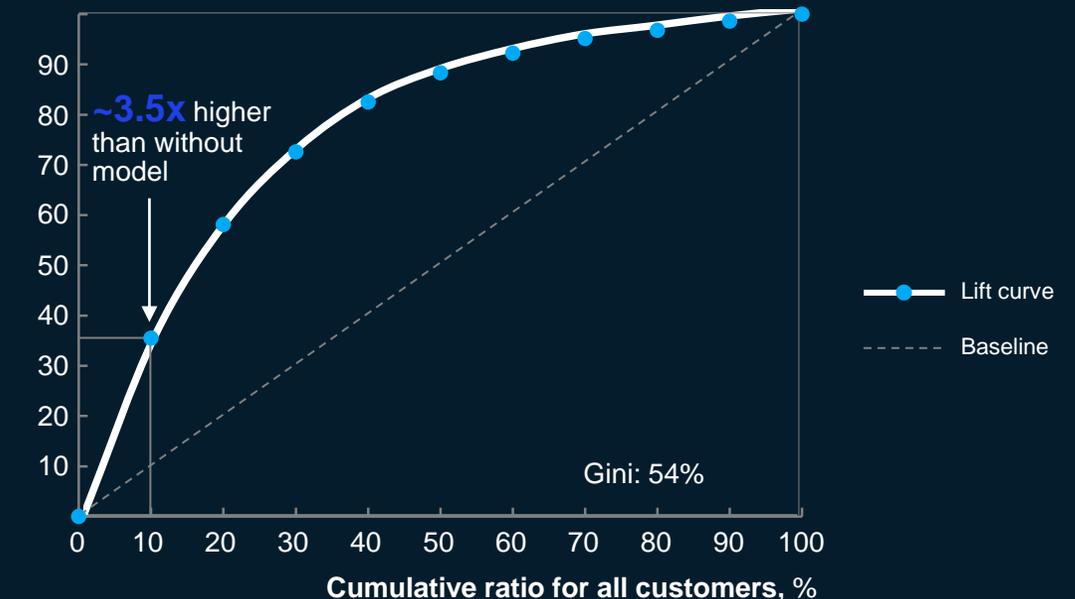


The model's performance has been verified; customers with scores in the top 10% account for 36% of all customers switching to another policy

## Cumulative gain graph

Cumulative customer ratio for each 10%

Cumulative ratio for customers switching to other policies %



1. Assuming P value threshold of 1% or less, with predictive model variables having statistically significant differences

# Example: Defining target architecture and technology operating model helped reduce this carrier's cost per policy significantly



Defined the new CIO target operating model and target architecture in terms of the planned acquisition of future life closed books portfolio.

- Validation and optimization of newly defined business and technical architecture model in terms of long-term growth ambition and expansion strategy, also in terms of short-term operational challenges
- Definition of the new COO and CIO target operating model with suitable IT target organization, core processes and governance structure, incl. sizing and location concept
- Development of an IT-talent and sourcing strategy, including required roles, skills and capabilities



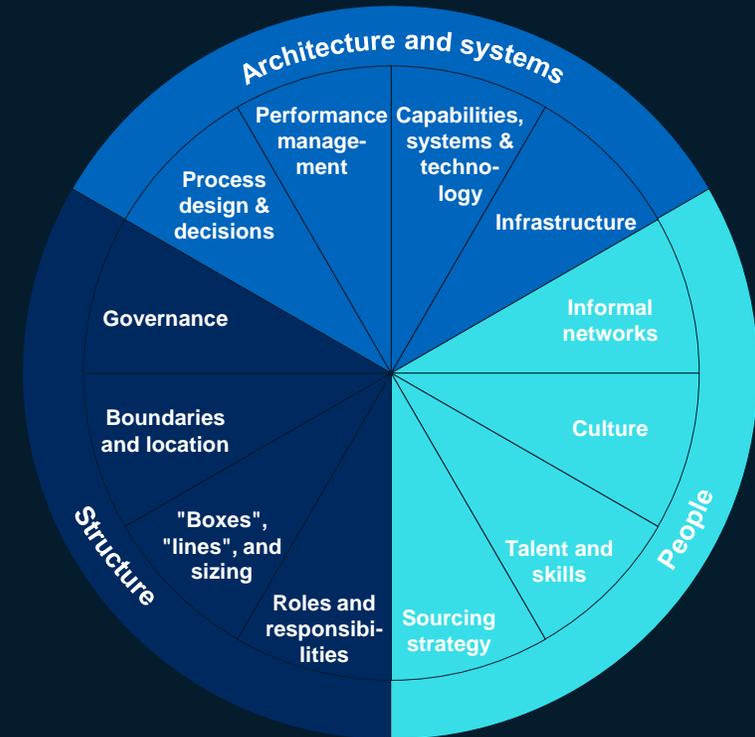
**Optimize IT target operating model for ambitious growth**



**Validate and update tightly integrated end-to-end architecture in terms of fast and seamless integration of new portfolios**



**IT Talent and people change strategy**



**Please contact us with any questions or comments**

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