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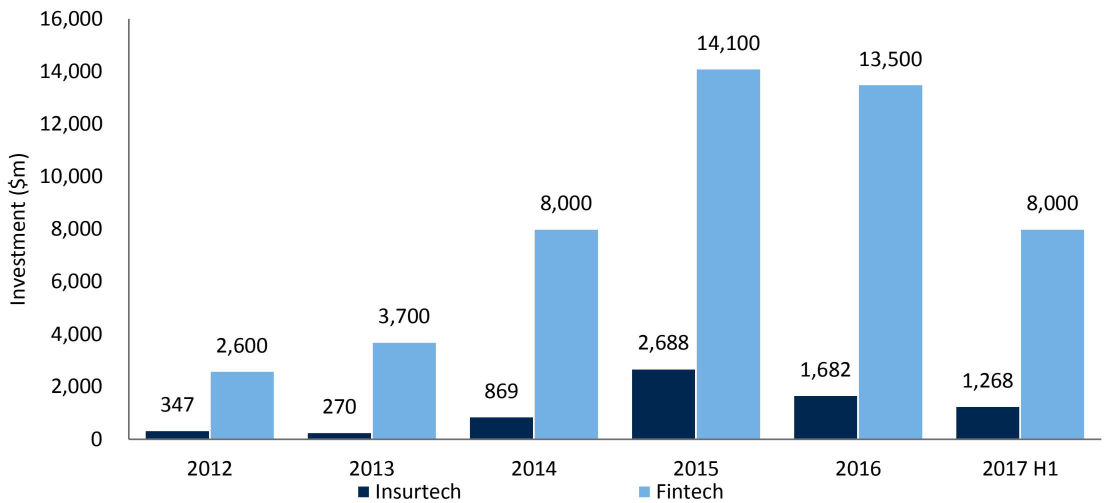
InsurTech Conversations: Volume 1 Oxbow Partners

In the first of a new monthly series of discussions with the InsurTech industry, we met with Chris Sandilands, one of the founders at Oxbow Partners, to get his thoughts on the sector. Oxbow Partners is a boutique advisory firm focused on insurance with a specialism in InsurTech. It was the sole advisor to Munich Re on the set-up of its Digital Partners division in 2016. **Please see p2-7 for full details.**

InsurTech is not a new phenomenon

Oxbow Partners defines InsurTech as young technology businesses with a proposition targeting the insurance industry. Based on this description, InsurTech is not new, however what is new is the frequency with which InsurTech businesses are launching. Despite this increase, InsurTech investment volumes are still lagging FinTech volumes for now due to the relative unattractiveness of the insurance market to entrepreneurs and the practical difficulties of launching an insurance startup.

Exhibit 1: InsurTech vs. FinTech funding levels 2011-2017 H1



Source: Oxbow Partners, CB Insights, WTW. FinTech funding only includes funding to VC backed to fintech companies

All parts of the value chain should benefit from InsurTech

Oxbow Partners believes that Insurers will benefit from InsurTech in data, policy admin and claims functions. Data is the focus of many startups, however Oxbow Partners is most bullish about the potential for a revolution in the claims process. InsurTechs should help insurers' claims processes to benefit from an increasingly connected world and the Internet of Things. InsurTech will inevitably change insurance products of the future, at present there is a battle between those that want to make insurance easier (such as Lemonade) and those that want you to care more about insurance (Trōv, Brolly) with the first of these groups gaining more traction at present.

Insurers are using different models to interact with startups

The insurance industry is using three main models to interact with startups at present: innovation teams, incubators and direct investments. A good example is Munich Re, which has an innovation team, an incubator and also makes direct investments into InsurTechs. Oxbow Partners believes that the right approach differs from company to company, but it is generally more sceptical about the impact that a Corporate VC can have.

Can you tell us a little bit about Oxbow Partners?

Oxbow Partners is a boutique advisory firm serving the insurance industry. We were founded in 2015 by a group of senior insurance advisors and executives who felt that there was an opportunity to provide more practical strategic advice to (re)insurance companies and brokers. A question we always ask ourselves when we deliver a strategy document is "does the client know what to do tomorrow?"

We are based in London but work internationally. Our practice areas are strategy, digital, M&A and risk. Our clients include some of the largest insurers, reinsurers and brokers in the world as well as some "challenger" brands.

In 2016 we were the sole advisors to Munich Re on the set-up of its Digital Partners division. Munich Re had spotted that InsurTech activity had picked up in 2015 and believed that it had a role to play. We were asked to define a strategy and proposition for the company. We then helped it implement this, ultimately launching the business in under 8 months from the start of the strategy project.

We have an active blog on our website where we cover an InsurTech business every week and discuss broader strategy themes in the industry.

For those not familiar with the space can you describe InsurTech? Is it a new thing?

The definition of InsurTech varies hugely depending on whom you ask. We define it as young technology businesses with a proposition targeting the insurance industry.

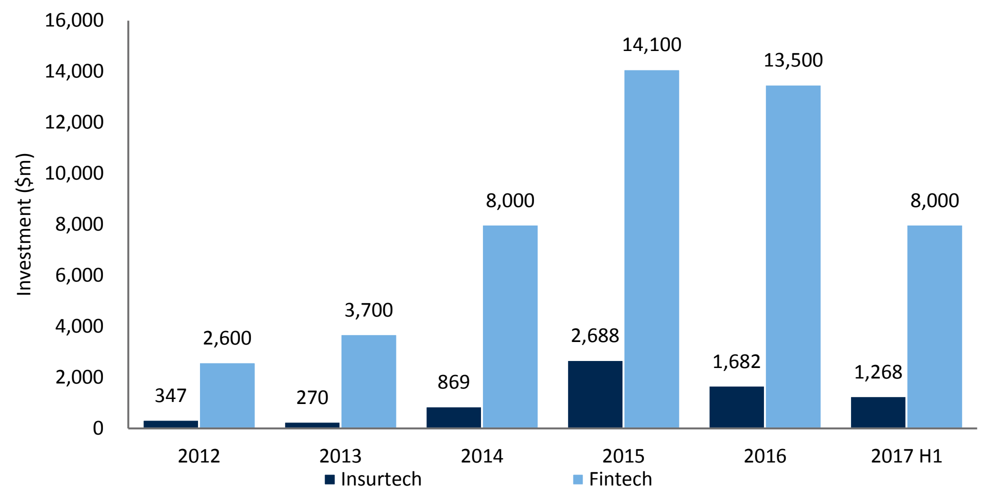
Based on our description, InsurTech is not a new phenomenon per se. What is new, however, is the frequency with which InsurTech businesses are launching and the manner in which they are operating. For example, there are now numerous insurance-focused incubators (e.g. Plug and Play, Startup Bootcamp) that are helping startups develop their ideas and connect with insurance companies. Never before has the industry been bombarded with so many distribution opportunities or vendors.

It is important to be clear that "what is the future of insurance?" is a fundamentally different question to "how will InsurTech change insurance?" The future of insurance will, to a large extent, be defined by exogenous drivers such as the development of autonomous vehicles and the role of global data companies in risk management and indemnity. To use a rowing analogy, InsurTech will make your boat go faster, but it won't win you a race against a speed boat.

How do InsurTech investment volumes compare to FinTech?

InsurTech investment is lagging FinTech by a considerable margin. The following chart shows investment volumes for the two segments over time.

Exhibit 2: InsurTech vs FinTech Funding Levels 2011 – 2017H1



Source: Oxbow Partners, CB Insights 'The Global FinTech Report: Q2'17' and WTW Quarterly InsurTech Briefing Q2 2017 and CB Insights 2015
Note: Fintech funding only includes funding to VC-backed fintech companies

There are two main drivers of the difference between InsurTech and FinTech investment volumes: the relative unattractiveness of the insurance market to entrepreneurs and the practical difficulty of doing an insurance startup.

What makes insurance a relatively unattractive market for entrepreneurs?

In corporate / speciality, the unattractiveness of the market is driven by inefficiencies that are obvious but firmly embedded in the market structure and culture. Startups like RI3K and various market initiatives have tried and failed to modernise the value chain through technology.

In other segments, the low-touch nature of insurance products presents few opportunities to build meaningful customer relationships. Cross-selling and up-selling rates are stubbornly low; growth must normally come from getting new customers, which is expensive.

Many FinTech products scale easier than InsurTech products. For example, once payments businesses like PayPal or Transferwise have acquired a customer they can drive revenue growth by encouraging those customers to use them regularly.

Given that most entrepreneurs are sector-agnostic, the insurance opportunity may not look as attractive as an opportunity in another, higher-velocity sector.

And why is the practical difficulty of doing an insurance startup greater than doing a FinTech startup?

There are three basic models that InsurTech entrepreneurs can pursue:

- Building a distribution business
- Setting up a new insurer
- Becoming a vendor to incumbent insurers and brokers

If an entrepreneur decides to build a distribution business, then the first challenge is to get access to a product (for broking structures) or capacity (for MGA structures). This is difficult; Oxbow Partners research in 2016 showed that this was a huge point of frustration for entrepreneurs. Insurers were keen to engage with startups but were too slow to make decisions and lacked capability, such as a flexible product engine to give startups the products they actually wanted.

Steven Mendel, CEO at the online broker Bought By Many (see Oxbow Partners' Bitesize profile on its website, 17th January 2017), remembers that it took him 11 months to get his first insurer signed up: "They said they wanted to meet urgently but I'd get a diary invite for 2 months in the future – that kind of timeline doesn't work for a startup."

Some entrepreneurs have, therefore, decided to set up their own insurers. Lemonade in the USA and ONE in Switzerland (see Oxbow Partners' Bitesize profile, 25th August 2017) are good examples. But this is not, in fact, an entirely separate option. A startup insurer is heavily reliant on reinsurance – nearly 70% of Lemonade's claims were paid by its reinsurers according to a recent filing – so in many practical ways, these companies have the same challenges finding capacity as startup distributors.

In any case, setting up an insurer is costly in terms of both capital (eg, need to raise risk capital and build a large team) and time (eg, long regulatory approval process). ONE insurance, for example, which has not yet launched, has raised over $30m, much of which was required as solvency capital for its regulated carrier.

We therefore believe that the benefit of setting up a risk carrier is not to accelerate launch by sidestepping the traditional market, but to create future flexibility. But, of course, what you do in the future is a moot point for most startups.

The third option is, therefore, to step away from distribution and become a vendor to incumbent insurers and brokers. Some examples are shown in the illustration below.

Exhibit 3: InsurTech activity across the value chain

Source: Oxbow Partners

These companies escape the challenges associated with finding products or capacity, but they suffer an equally tricky problem – the corporate procurement process. Whilst many corporates have invested in building innovation teams or labs, few have recognised that these units still work within the broader corporate framework. In other words, the procurement team does not have a "startup grade" process and uses the same questionnaire for startups as it uses for a major outsourcing project. Invariably startups will "fail" the process and the partnership will be significantly delayed at best. Similar problems emerge in other central functions such as compliance and legal.

To set up many FinTech businesses you need one thing from the bank: a bank account. For a payments or investment management business you don't need the bank to do any product innovation or make any technology investments. And most critically, you don't need a large corporate balance sheet behind you to catch unexpected losses. (This is not to underestimate the other technical, commercial and regulatory challenges of setting up such a FinTech.)

As a result, the banking model is arguably more vulnerable than the insurance model to the impact of technology – and the reason why, historically, more entrepreneurs have been attracted to banking than insurance.

In which parts of the value chain do you think insurers can benefit most from InsurTech?

Insurers will benefit most from InsurTech in three areas: data, policy admin and claims.

Data has become the focus of many startups. These companies are doing all sorts of innovative things. For example, Cytora is scraping public data from the web, structuring it and building risk scores. Aerobotics is using drones to collect data about crop health and providing this to agro insurers. Insurers are still working out how to use this data, but it seems likely that there are going to be use cases and benefits to those who find them first.

Policy admin is an often overlooked but potentially exciting InsurTech opportunity. Most insurers are constrained in their efforts to innovate (which could be simply incremental change) by their legacy platforms. It can cost hundreds of thousands of pounds and several months to create a new product. Contrary to popular belief, the policy admin system market is not an oligopoly: the Oxbow Partners database contains over 200 such systems. Whilst replatforming is a huge (sometimes impossible) project for many insurers, there is an opportunity for insurers to build "proof of concept" platforms, for example, which they use to validate new ideas. At the very least, this approach allows them to understand which products are worth building on their expensive legacy systems.

Finally, we are bullish about claims. The claims process is about to undergo a major revolution. If you've got a leak in your house today you'll get home later, see it, and call your insurer tomorrow. In a world where connected devices are ubiquitous, you'll know that you've got a leak instantly – and there are opportunities for insurers to build prevention or containment propositions, rather than just repair. But that will require insurers to be able to receive the claim notification from your sensors electronically, and to have a supply chain that is much more agile to benefit from the swift notification. InsurTechs will help insurers with these kinds of challenges. Neos (see Oxbow Partners' Bitesize profile, 21st October 2016) is pioneering a connected home proposition. Others are providing technology that can help insurers move their proposition ahead. For example, 360globalnet has a platform that helps insurers with claims management and loss inspections, Snapsheet supports the adjusting process.

Do you expect insurance products to change due to InsurTech startups? Are there any examples of this?

Inevitably, there will be change: the question is how material this change will be.

Rob Moffat of Balderton Capital, the VC fund, observed on our blog about InsureTech Connect in Las Vegas last year that there appears to be a battle between players who want to make insurance easier (eg, Knip, Lemonade) and those who want you to care more about insurance (eg, Trōv, Brolly). We think this battle is being won by the former group at the moment: Bought By Many and Lemonade appear to be getting good traction.

However, we think the real change will come as a knock-on effect of other changes. We already described the possible impact of sensors on the home insurance claims process. Policies will have to change to respond to these trends, and InsurTech will help insurers update their propositions.

What are the approaches that the insurers are taking to interact with InsurTech startups? Are some approaches better than others in your view?

We believe that InsurTech is a tool, rather than an end in itself. This means that corporates should continue to focus on their strategy – which should be influenced by the opportunities and threats that new technology presents – and then consider which InsurTechs can help them achieve their objectives. That then leads naturally to considerations about the most suitable engagement mechanisms. As a result, the best way to interact differs from company to company.

Broadly speaking, there are three models that insurers are using to engage with startups: innovation teams, incubators and investment. These are illustrated below with some examples.

Exhibit 4: Models used to engage with startups

	Innovation teams	Incubators	Investment
Munich RE	Innovation teams	MundiLab Powered by Munich RE Digital Partners	Munich Re / HSB Ventures
AXA	Innovation teams	kamet	AXA Strategic Ventures
AVIVA	Aviva Digital Garage	Founders Factory	AVIVA Ventures
XL CATLIN	XL Accelerate	startupbootcamp	XL Innovate

Source: Oxbow Partners

Innovation teams operate most closely to the core business. They generally have a broad mandate to change the way the business thinks through whatever means are effective. Their main challenge is that it is often an uphill struggle effecting change from a matrix position in a large corporate. They are also normally restricted to incremental innovation because – as they say – turkeys don't vote for Christmas, so you are unlikely to achieve disruptive change working with the business. They are often good at making connections to startups, but don't always have the clout to push these through to pilots or implementations.

Incubators help startups bring their products to market by connecting founders with mentors and corporate partners. Two of the better-known ones are Startup Bootcamp InsurTech in the UK and Plug and Play in the US. Some of the largest companies have also set up their own incubators, for example Munich Re's Mundi Lab and Swiss Re's incubator in India.

The objective is for corporates to forge partnerships with startups. We refer to our earlier comments about the governance challenges of developing these partnerships; incubators are not a silver bullet.

Finally, many insurers have started investing in InsurTech. Until recently, this was only done through corporate venture funds. We are sceptical about insurers' ability to generate value by investing directly in InsurTech through corporate VCs: what is the differentiator against private venture funds, especially if an insurer investment does not lead immediately to a vendor partnership with the insurer? Munich Re is the only corporate venture fund we know that has solved this problem: an investment requires an underwriting partnership agreement with the Digital Partners division.

Recently a few specialist InsurTech VCs have emerged, for example InsurTech.vc in Cologne and Eos Venture Partners in London. Some of these funds are offering operational support to their investors: we are more bullish about this model.

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