CFA SINGAPORE INSIGHTS

By Alan Lok, CFA, Eunice Chu, and Guruprasad Jambunathan

Undercover analysis: assessing insurance companies

Some of the key factors to be kept in mind at a time when innovative disruptors are transforming the industry

INSURANCE is a curious sector. In years gone by, it has been regarded as something of a cash cow, with the likes of Warren Buffett treating the float as a source of money to be invested elsewhere.

Insurance companies were also seen as sclerotic, with time-consuming processes that often placed the customer last. It's not because these firms didn't care. Instead, it reflected an ingrained culture that didn't quite know how to change.

Then technology arrived. The forces of disruption were quick to spot the inherent opportunities in the sector, and the attention of digital suitors now envelops insurance firms. These include cloud computing, big data analytics, artificial intelligence (AI), the blockchain, drones and the Internet of Things (IoT). The reshaping of the industry is taking place in several domains:

- **Customer acquisition and marketing** – the emergence of a more targeted approach when identifying customer groups.
- **Claims** – a rise in automated handling with on-demand case information.
- **Underwriting and product pricing** – with a deeper well of customer information to hand, costs are becoming fairer and more accurate.

Let's move on to how we should analyse insurance companies.

Within Singapore, the three leading companies listed on the SGX are (in order of size):

- Great Eastern (S$10.3 billion);
- United Overseas Insurance (S$383 million);
- Singapore Reinsurance (S$188 million).

Insurance firms that can reshape their business models to accommodate the click-and-buy generation will be the leaders of tomorrow.

Demand drivers

Insurance is an umbrella term that covers various types of product offerings, so begin by finding out what the firm you are analysing sells. Is it household policies or corporate cover? And in which markets does it specialise – institutional or industrial, for example? Is its customer base in developed or emerging territories?

With this product information to hand, establish which macroeconomic factors are affecting demand for insurance. Examine changes in income levels, business activity and GDP growth, bearing in mind that when times are tough, insurance can get pushed down the priority list with customers failing to renew their policies or avoiding cover altogether until the climate improves.

Indeed, affordability is another critical aspect to note. Compare the cost of a company's products with the average income levels in its target markets. People are always willing to expose themselves to risk if the cost of a policy is at odds with the cover provided, so look too at how prices are evolving – is this in sync with changes in personal income?

How do levels of competition affect the prices a company charges for its products? To answer this question, learn about a company's market share in terms of the number of policies sold and premiums earned. Find out where it sits relative to its peers – is it a top-three or top-five player?

Also, try to establish if any factors will help or hinder the arrival of new entrants – the market could either become saturated or remain static.

Company activity

Turning to company specifics and study its track record in investing premiums – this is important, as it will determine the health of the aforementioned float (the difference between claims paid and premiums collected). From an expansion perspective, it is worth judging the businesses strategy and track record in launching new products and its ability to attract clients after that. Moreover, once it has attracted new customers, does it treat them fairly? A helpful benchmark is the claims settlement ratio and grievance ratio.

Environmental, social and governance (ESG)

We closed the previous section by touching on the treatment of customers, which is an integral part of an insurance company's approach to ESG. Among other things, establish the total amount of claims that are currently under dispute and if the firm is presently facing any litigation or legal proceedings. Also, how does the company protect the privacy of clients and ensure the safety of the data it holds?

Market structure

You need to assess the current structure of the insurance market and the long-term factors that are expected to drive growth. What type of policies dominate the market and how are they being sold – directly via online platforms or offline through brokers or bancassurance channels? Are there specific products market leaders and how will this evolve – for example, travel, home and vehicle insurance are well-established as online offerings; however, specialist business insurance is likely to be purchased offline through a broker.

An understanding of market maturity is another useful tool, so screen the penetration levels of different products in a company's operating sphere in relation to overall economic maturity. How are these levels expected to evolve and which products will benefit (or lose out) from these changes?

The race to innovate

Earlier, we touched on the innovative disruptors which are transforming the insurance sector. To close this sector analysis, it is worth highlighting a crucial factor that will dictate the future direction of the industry, and that is the receptiveness of a new breed of consumers to on-demand products. Insurance companies that can reshape their business models to accommodate the click-and-buy generation will be the leaders of tomorrow.

Moreover, as smart-home sensors are fitted as standard, wearable health sensors become inseparable from our wrists, and cost-effective drones assess building damage, then insurance firms will have an efficient and accurate big-data platform to help them to filter out high-risk groups. In turn, pricing will be fairer – honest customers will be less exposed to the activities of fraudulent claimants.

Alan Lok, CFA, is the director, Society Advocacy Engagement, of CFA Institute. Mr Lok researches and writes on investor-protection issues and capital-market structure.
Eunice Chu is an ACCA-qualified finance professional. She was a regional finance director of a Fortune 500 multinational corporation and, at present, heads the policy function of ACCA Hong Kong.
Guruprasad Jambunathan, FRM, is a director for financial research at CRISIL, a global analytical company.

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