CEO Brief

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CEO Brief is a report highlighting key current issues the insurance industry faces.

Big Tech in Insurance – Opportunities and Risks

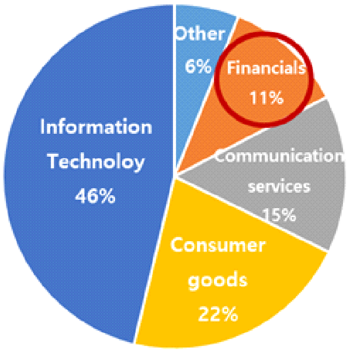
ABSTRACT

Recently, Big Tech has rapidly expanded to provide financial services including insurance in order to strengthen their core businesses (non-financials). Big Tech's entry into the insurance market may pose risks such as consumer attrition and decrease in market power for the incumbent insurance companies through intensified competition. However, it may also be an opportunity to diversify business and improve consumer satisfaction by digital transformation. To encourage market innovation and to improve consumer welfare, the policy authority needs to ensure fair competition among incumbent firms and new entrants, incumbents' resilience as well as financial stability, greater consumer protection, and financial inclusion for high-risk groups.

1. Big Tech's entry into financial services

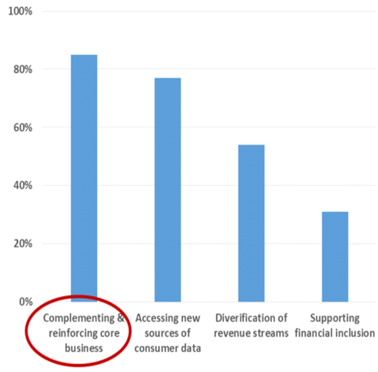
Recently, Big Tech firms have rapidly expanded to provide a wide range of financial services such as payment services, credit, asset management and insurance in order to strengthen their core businesses revolving around non-regulated and non-financial activities. Big Tech is a giant IT company with a large consumer base, and its core businesses is platform-based (for example, electronic commerce (Amazon), social media (Facebook), or search engine (Google)), hardware manufacturing (Apple), or telecommunications business (Vodafone). The reason why Big Tech is expanding into the financial market despite lower profitability than its core business is mainly to strengthen and complement core business by enhancing its consumer base and loyalty. Accessing new sources of customer data and diversifying business lines are other reasons to expand.

〈Figure 1〉 Big Tech's revenues by sector of activity



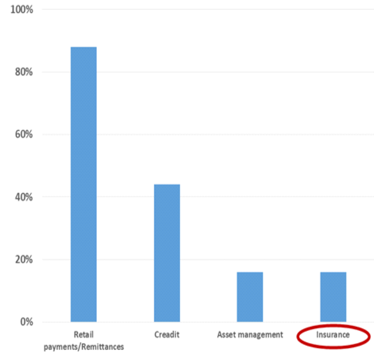
Source: BIS(2019)

〈Figure 2〉 Motivation for Big Tech to provide of financial services



Source: FSB(2020)

〈Figure 3〉 Big Tech financial service offerings



Source: FSB(2020)

Competitiveness in Big Tech's entry into the financial market emerges from the economies of scope and scale due to complementarities between financial and core non-financial services. Big Tech's business model forms a data-network-activities (DNA) loop.; network formation based on consumer data, user activity promoted by network, and new consumer data generated by the promoted activities completing the loop(BIS 2019). Big Tech's entry into the financial market will not only utilize Big Tech's existing DNA loop, but will strengthen it to further solidify its overall business model.

Big Tech can enter financial market either by obtaining their own licences or by partnering with other financial companies. If Big Tech's core business is platform-based, it is more eager to enter the financial market; and the less developed the financial infrastructure and the lower the level of financial regulation (for example, emerging markets), the more the Big Tech is likely to be licensed as a financial company and compete directly with incumbents.

2. Impacts of Big Tech's entry on insurance services

Big Tech's entry to the insurance market with novel business models can induce innovation and increase consumer welfare through elevated competition. Big Tech's data, networks, and analytical technologies help develop various insurance products and services by reducing information costs and transaction costs, which can lead to innovation in the insurance market. In addition, insurance consumers can make an easy access to the insurance market and insurance companies can improve consumer satisfaction by providing personalized products and services.

On the other hand, in terms of market competition, financial stability, and consumer protection, new types of risks may arise, increasing the possibility of market failure at the same time. The partnership between Big Tech and an insurance company can be abused as a means to avoid regulations. Due to the nature of the Big Tech's business model, it is easy for a dominant platform to emerge undermining market efficiency through unfair competition and market concentration. Moreover, excessive competition between Big Tech and insurance companies can worsen the profitability of the insurance companies, which can drive them into more risk-taking behaviors. And Big Tech's enlargement and high interconnectedness with non-financials could impair financial stability. Finally, as the rights and responsibilities of insurance market participants become more complicated, consumer protection issues can arise and excessive product differentiation can lead to financial exclusion for high-risk groups.

3. Public policy towards Big Tech in insurance

Big Tech's entry into insurance business may pose risks such as consumer attrition and decrease in market power to the incumbent insurance companies through intensified competition. However, it may also be an opportunity to diversify business and improve consumer satisfaction.

If Big Tech enters the insurance market by obtaining its own license, it can develop novel insurance products and services with differentiated data and technological capabilities; then, potential consumers (especially, MZ generation) of the existing insurance company could switch to the Big Tech. In addition, if Big Tech sells insurance products in partnership with an insurance company, the excessive fees resulting from Big Tech's superior position not only reduce the profitability of the insurance company, but also take out the interface with the customer base. As a result, the insurance company may no longer be able to accumulate consumer data.

On the other hand, the insurance companies can diversify its business by creating a new profit base and improve consumer satisfaction by enhancing the innovation of products and services by benchmarking Big Tech's new business model and digital innovation. In order to do so, the insurance companies need to make efforts to ensure competitiveness in the digital environment through successful digital transformation by establishing contact points with consumers, building partnerships with IT companies, developing and training human resources for digital finance, and accessing high-quality consumer data.

To encourage market innovation and to improve consumer welfare, the policy authority needs to ensure fair competition between incumbents and new entrants, to reduce possible impacts on incumbents' resilience as well as financial stability, to ensure greater consumer protection, and to prevent financial exclusion for high-risk groups. It is necessary to check regulatory arbitrage when Big Tech provides the similar financial services as incumbent insurance companies, and to contain the proprietary utilization of data and technology by building a dominant platform.

Also, it is necessary to monitor insurance company's risk-taking behavior due to intensified competition, to prevent Big Tech's non-financial risks from being transferred to the financial business, and to manage concentration risk due to a dominant platform. Finally, it is necessary to protect consumers using products and services through platform and to ensure high-risk consumer's access to the insurance market from excessive product differentiation.

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