Article from

Product Matters

June 2018

Issue 110

Shared Value Insurance: Award Winning Innovation

By Alan Pollard and Benny Rubin

Shared-value insurance has emerged as a new category of insurance and is capturing a large number of industry innovation awards both in the USA and internationally. The concept of "shared value" was first introduced by Michael Porter and Mark Kramer in their seminal work in the *Harvard Business Review*. They formally define it as "a framework of framing policies and operating practices in such a way that enhances the competitiveness of a company while simultaneously advancing the economic and social condition in the communities in which it operates." The framework puts an equal weighting on creating economic value and addressing societal needs and challenges. It operationalizes this philosophy by identifying and expanding connections between societal and economic progress. Shared value can also be expressed as a type of management strategy where a business aligns its objectives with success of all its stakeholders.

Kramer and Porter argue that is imperative to embrace a shared value approach for long-term growth in a world where the role of business in society is changing due to increasingly liberal societal trends and consumer-centric regulatory reform.

While many (if not all) sectors can benefit from a shift in mindset towards a shared-value approach, the insurance industry is uniquely positioned to take a significant advantage from this proposition.

HOW INSURERS ARE UNIQUELY POSITIONED TO BENEFIT FROM A SHARED VALUE APPROACH

The insurance industry's primary function is to protect individuals and organizations against the financial risk arising from the occurrence of adverse events. When an insured adverse event occurs, the insurer is contractually obligated to pay the resultant claim (i.e., the insurance industry monetizes risks). Insurance companies suffer when adverse events occur more frequently or more severely than expected and benefit from the opposite. It follows that when societal conditions improve, such as with a reduction of the disease burden, a decline in the frequency of accidents, and general improvements in societal wellbeing, the industry becomes more profitable and/or more competitive. In fact, it is likely that the only other stakeholder with such a direct economic interest in such improvements is government.

Porter argues that "insurance is the ultimate shared value industry, where social impact is integral to economic success." However, most insurers remain rooted in the passive actuarial model of upfront risk selection and pricing followed by claims mitigation. Insurers benefit more than almost any other industry from societal advances (in health care and in health awareness in particular) but lag behind in proactively tackling the societal conditions that will most affect their business. Insurers to date have largely and somewhat surprisingly overlooked opportunities to enhance outcomes for their customers, society and ultimately, for themselves.

THE CHANGING NATURE OF RISK, THE HEALTH CARE PARADOX AND THE POWER OF INCENTIVES

The Changing Nature of Risk

It is now widely understood that lifestyle factors play a significant role in the modern disease and mortality burdens. The Oxford Health Alliance termed a useful phrase of 4-4-60 to help aid this understanding—four lifestyle behavior factors (physical inactivity, poor diet, tobacco use, and excess alcohol intake) are associated with four chronic diseases (cardiovascular disease, diabetes, chronic lung disease, and various cancers) that contribute to 60 percent of deaths worldwide (see Figure 1).

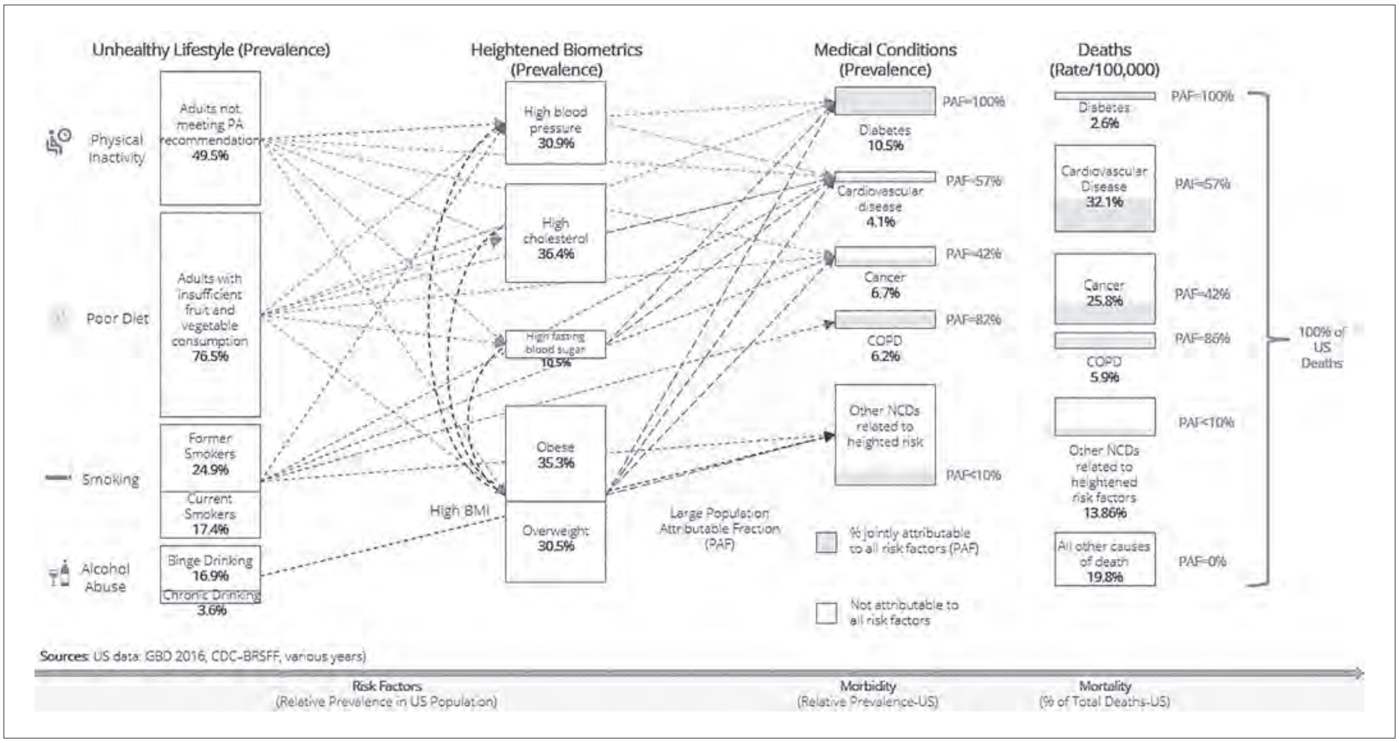
The Health Care Paradox

Yet with all this understanding most societies perpetuate the paradox of over-consuming health care but under-consuming prevention. Health systems are known to spend as little as 2 percent of health expenditure on preventive and lifestyle related services despite the oversized role these play on the disease burden.

The individual consumer similarly falls victim to this. In consuming health care services, the cost of health care is often hidden (paid by insurer or national health) while many of the benefits are immediate, leading to over-consumption. With prevention, the cost is evident (time taken to excersize or restraint required to avoid that slice of cake) however the benefits only materialize in the future—leading to under-consumption.

The trade-off of instant gratification over long-term wellness, coupled with the fact that people are irrationally over-optimistic about their abilities to overcome health issues, means that people tend to make poor and short-sighted decisions when it comes to their health.

Figure 1
Mortality Drivers



Behavior Change through Nudges

Despite the difficulties noted above it has been shown that short-term nudges in the form of incentives and appropriate messaging have been effective drivers of behavior change.

APPLICATION OF THE SHARED-VALUE MODEL TO INSURANCE

We've established that an insurer can generate risk savings if its clients improve their health. We've also seen that clients can improve their health by making healthier lifestyle choices though they typically tend not to as explained by a variety of behavioral economic theories. Yet certain tools have been shown to be effective in driving healthy behavioral change.

If the insurer can facilitate the improvement of its clients' health, the portion of the subsequent insurance savings can be used to provide incentives that encourage clients to make healthier choices, so fuelling a virtuous cycle of value creation and health improvement. This is the essence of the shared value insurance model: addressing the shortcomings of human behavior and insurance design, and integrating the two into a powerful form of insurance that actively promotes health improvement.

Shared value's application to insurance was pioneered by Discovery, a South African financial services group. Discovery conceived this new category of shared value insurance with its innovative business model, Vitality. Vitality aims to improve health outcomes through behavior-change incentives that are focused on health promotion. The business model simultaneously provides material benefits to Discovery, its clients, and society as a whole. Vitality is now partnered with a network of leading global insurers who use the model in their markets to transform their insurance offerings, and the health of their clients.

HOW VITALITY WORKS

Members of the Vitality program are awarded Vitality points over the course of the year, based on the wellness activities they complete, which include increasing physical activity, purchasing healthy foods, assessing their health profile, having appropriate preventive screenings and more. These points-earning activities are designed to tackle the lifestyle factors discussed above, and are aligned to the impact that completing that activity will have on health outcomes. Vitality points aggregate towards a Vitality status. The higher the status the higher the level of rewards—such as substantial discounts at retail and travel partners. These rewards and discounts are funded through the enhanced insurance savings that result from the client's improved risk profile. But perhaps most meaningfully there is also a direct insurance advantage—clients can lower their insurance contributions through demonstrating positive lifestyle behaviors. Instead of underwriting the policyholder at a single point in time and locking in a rate forever, the insurer now has the opportunity of continual engagement with the policyholder and getting up to date insights on the underlying risks they are covering. In many of the markets in which Vitality operates, the insurer gives the policyholder an upfront "benefit of the doubt" that they will engage in healthy behaviors. This results in a competitive advantage of up to 15 percent of premium. If the policyholder doesn't demonstrate healthy behaviors their premium will adjust upwards over time.

The Dynamic Pricing Model

The model in Figure 2 leverages the behavioral economics principles of nudges and incentives, personalized technologies including wearables and smartwatches, and data analytics to facilitate incremental positive changes in lifestyle and health behaviors. The model has been shown to lower morbidity and mortality rates, and consequently the cost of claims. A portion of this actuarial surplus is recursively channelled back to clients in the form of rewards and dynamic premium pricing.

The Vitality Shared Value Model

The Vitality Shared Value Insurance model in Figure 3 not only creates a virtuous cycle of value-creation, it depends on it for its own sustainability. The value that is created and subsequently shared is not confined to the insurance environment. The network of reward and retail partners is critical to the success of the model and these partners share in the value creation through increased revenue, improved customer loyalty and exposure to a broader customer base.

IMPACT OF THE MODEL

Framing insurance in the shared value construct transforms a traditional grudge purchase into a driving force for societal change. *The Guardian* describes this transformation as an example of a business "grabbing hold of a social issue that is at the core of their business, and figuring out how to wrap that into their strategy

Figure 2
Dynamic Pricing Model

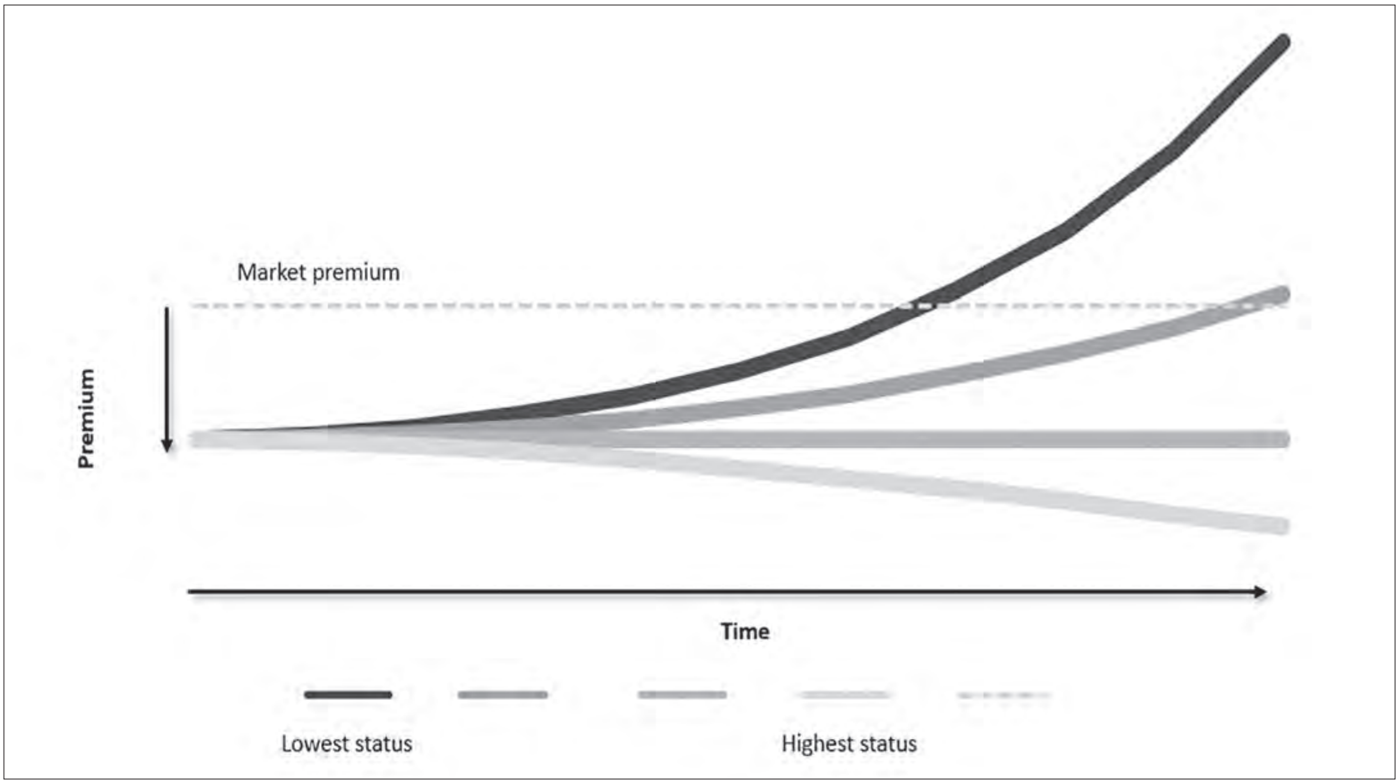


Figure 3
Vitality Shared Value Model

and operations."[1] After capturing a large proportion of South Africa's private health insurance market, Discovery introduced behavioral incentives to motor and life insurance clients, creating synergies across these lines by integrating Vitality, and thereby reducing car accidents and lowering medical and life claims.

Discovery's success in South Africa has led to the development of the Global Vitality Network, an alliance of powerful global insurers: AIA (Asia), Ping An (China), Generali (Europe), Sumitomo (Japan), John Hancock (U.S.), Manulife (Canada), Vitality Life & Health (U.K., previously a Prudential and Discovery JV), and Discovery (South Africa). It now operates in 16 countries.

The insurance industry holds a vital role in local systems and is uniquely positioned to monetize better societal outcomes. The opportunity to use this powerful force for good is a refreshing proposition in the context of an often stagnant industry. A shared value mind-set aligns the health of members, the bottom line of insurers and the wellbeing of society. ■

Alan Pollard is a Fellow of the Actuarial Society of South Africa and the Institute of Actuaries. He currently serves as President, Global Product and Innovation for Vitality Group and serves on the Board of Directors and Executive Committee of Discovery. He can be reached at *alan.pollard@vitalitygroup.com*.

Benny Rubin is an actuarial analyst at Discovery. He is involved in the roll-out of shared value Vitality products to Discovery's global insurance partners. He can be reached at *benny.rubin@vitalitygroup.com*.

ENDNOTES

1 *Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility* by Prof Michael E. Porter and Mark R. Kramer.

2 *https://www.theguardian.com/sustainable-business/blog/creating-shared-value-social-progress-profit*