



Leaders of Tomorrow
An International Insurance Society Program



Beyond Underwriting Profit

Insurance-Capability-Led Ownership to
Preserve the Insurance Safety Net

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Executive Summary

This paper examines how insurers can preserve their role as a social safety net when the traditional foundations of insurance risk-taking are becoming less reliable. Climate change is reducing the usefulness of past data and statistics in estimating future losses, while advances in genetic testing and restrictions on insurers' access to risk information may widen information asymmetry and increase adverse selection. These developments could make it increasingly difficult for insurers to maintain stable and adequate underwriting margins.

This paper proposes **Insurance-capability-led ownership**, a diversification model in which insurers acquire and develop established non-insurance and non-financial businesses by applying core capabilities beyond risk-taking, such as brand, distribution, a long-term and stable investment approach, and accumulated data.

The paper examines the economic rationale for diversification, the limitations of insurance-adjacent businesses, the criteria for selecting target businesses, and the governance required when insurers enter industries in which they lack operating expertise. It recommends focusing on businesses with meaningful scale and stable cash flow, where insurers can create value beyond providing capital. By building independent sources of earnings through diversification under appropriate discipline, insurers can support sustainable corporate growth while continuing to provide the risk protection on which individuals, businesses, and society depend.

Problem Statement

Private insurance complements the role of government and functions as a safety net for society. Life insurers provide protection that supplements public healthcare systems, old-age pensions, and survivor pensions. Property and casualty insurers support stable economic activity. For example, the geopolitical tensions in the Strait of Hormuz in 2026 affected shipping and maritime trade through restrictions on war-risk insurance coverage and higher premiums.¹

The core function of both life and property and casualty insurance is risk-taking. Insurers cover uncertain events in society and compensate policyholders for economic losses when insured events occur. To perform this function, insurers use statistical data to measure risk whenever possible. When statistics alone are not sufficient, insurers use their underwriting expertise to make the risk commercially viable.

However, the conditions that support this form of risk-taking are changing. The first change is a widening information asymmetry between insurers and customers. The legal and social environment surrounding the use of customers' genetic information is changing. Genetic testing cannot currently determine when a specific disease will occur, and the information it can provide remains limited. However, its accuracy and scope may improve over time. At the same time, several countries restrict insurers from obtaining or using genetic information, and some are considering broader restrictions.² These restrictions can widen the information gap when customers know more about their own risks than insurers. This can increase the risk of adverse selection.

The second change is that the assumption that past data can predict future risk is becoming less reliable. Climate change reduces the usefulness of statistics that project future risk as an extension of past data. For example, repeated wildfires in California and rising hurricane losses in Florida have led several large property and casualty insurers to stop writing new property policies or reduce renewals in these markets. When insurers have limited access to risk information and past data become less accurate in estimating future losses, it becomes more difficult to select risks, set prices, and calculate required capital.

Under these conditions, insurers may find it increasingly difficult to earn stable and adequate underwriting margins and continue the traditional risk-taking business model. Many insurers around the world are stock companies and are expected by capital markets to increase corporate value. As the conditions for risk-taking continue to change, insurers need to review their existing business structures so that they can maintain their social function and achieve sustainable corporate growth.

Proposal of This Report

Climate change is reducing the usefulness of past statistics, while advances in genetic testing may widen information asymmetry. These developments are changing the

conditions that support risk-taking in insurance. As a result, insurers may find it difficult to maintain underwriting as their main source of profit in the future.

Insurers have two broad options to offset a decline in underwriting profit: improve the profitability of their existing businesses or diversify into other businesses. This report proposes a second option. It presents a model in which insurers enter non-insurance and non-financial businesses by using their core capabilities other than risk-taking. This model is called Insurance-capability-led ownership.

This report examines the proposal through the following five questions.

- Is business diversification an economically irrational corporate action?
- What core capabilities do insurers have other than risk-taking?
- Why are businesses adjacent to insurance not sufficient?
- What criteria should insurers use when selecting businesses beyond adjacent areas?
- How should insurers invest in and manage businesses when they do not have industry expertise?

The following sections address these questions in order.

Five Questions to Examine the Proposal

Is business diversification an economically irrational corporate action?

Capital markets and management research have criticized corporate diversification since the twentieth century. Many companies now pursue portfolio focus. Private equity firms also use measures such as leveraged buyouts. One purpose of these actions is to remove value loss associated with diversification, commonly called the conglomerate discount. Capital markets often view coordination costs, agency costs, inefficient capital allocation, and less transparent financial reporting as factors that reduce the value of diversified firms.

However, recent quantitative studies using German and Japanese company data do not support treating diversification itself as a cause of operating inefficiency or value destruction. A study of approximately 6,000 German firm-years found a conglomerate discount in its initial estimates. However, after accounting for the fact that firms choose whether to diversify, the study found no causal relationship between diversification and lower market value.³ This result suggests that at least part of the observed conglomerate discount may come from the characteristics of firms that choose to diversify or from research design choices, rather than from diversification itself. Similarly, a study of Japanese listed companies found that diversified firms maintained EBITDA margins at a level comparable to focused peers.⁴ The median difference in EBITDA margin between the two groups was approximately zero, or 0.0 percentage points. The study did not find that diversified firms had lower profitability than focused peers. These German and

Japanese findings show that diversification itself cannot be treated as a cause of corporate value destruction.

In addition to quantitative findings, diversification can have economic benefits for qualitative reasons. First, diversified firms can use the capital base and organizational scale built by their core businesses to enter new growth areas. Second, portfolio theory suggests that combining businesses with imperfectly correlated earnings streams can reduce volatility in total corporate earnings. Third, diversified firms may be able to increase the value they provide to customers.

A focused firm that provides only one product or service may not always offer the best form of value to the customer. For example, customers may find a composite insurer that offers both life and property and casualty insurance more convenient than separate providers. They may also find a financial conglomerate that includes banking services more convenient than a composite insurer. Based on these studies and considerations, this report concludes that diversification under appropriate discipline is not an economically irrational corporate action.

What core capabilities do insurers have other than risk-taking?

When an insurer diversifies into non-insurance businesses, what core capabilities can the insurer, as the corporate parent, provide to the target business? The type and strength of these capabilities differ by insurer. However, the insurance business model generally gives insurers four core capabilities.

The first capability is brand, which can provide quality assurance. Insurers have built strong brand value in both global and local markets. For example, several insurers regularly appear in Interbrand's Best Global Brands top 100. Several local insurers also appear in Interbrand's country rankings. As signaling theory suggests, a strong brand can act as a signal of quality and reduce the perceived risk that customers face when purchasing a new product or service. The trust attached to the brand can also help the target business attract strong talent in the labor market.

The second capability is distribution, or customer access. Many insurers have developed proprietary sales channels or broad agency ecosystems covering large geographic areas. These channels allow insurers to reach both individual and corporate customers and distribute products and services at scale.

The third capability is a long-term and stable investment approach. Insurers use asset-liability management, or ALM, to prepare for long-term claim payments. ALM is a core principle of investment management. Unlike investment funds that mainly seek short-term capital gains, insurers can invest capital in a target business with a long-term view and provide stable liquidity over time.

The fourth capability is accumulated data. Because of the nature of their business, insurers systematically accumulate large amounts of data on customer attributes,

policies, life events, claims, and various risks. Insurers already use this data in underwriting, claims handling, marketing, and customer management. However, many insurers have not fully used these data to create value beyond their core insurance operations. When these data assets are combined with a non-insurance business that can use them, they can become a source of competitive advantage for the target business.

This report therefore defines four core capabilities that insurers hold in addition to risk-taking and underwriting: brand, distribution, a long-term investment approach, and data.

Why are businesses adjacent to insurance not sufficient?

Expansion into businesses adjacent to insurance is not sufficient to address the issue in this report: preparing for a future in which underwriting may no longer remain commercially viable. There are two reasons.

The first reason is the limited ability of preventive solutions, such as risk advisory services, to create an independent profit base. It is often difficult to measure the effect of a preventive solution after the service has been provided. As a result, customers may have little incentive to pay a high price for the service on a stand-alone basis. In addition, these services often need to be bundled with insurance contracts to generate revenue. If the conditions supporting the core risk-taking business change, preventive solutions linked to insurance contracts may lose their revenue base at the same time. Therefore, preventive solutions alone are not sufficient to address the issue examined in this report.

The second reason is the limited scale of vertical integration within the insurance value chain. Insurers should pursue vertical integration within the existing value chain when it improves efficiency. For example, a property and casualty insurer can internalize roadside assistance services. This can reduce external service fees and create direct operating synergies. A life insurer can also internalize asset management. This can reduce conflicts of interest from outsourcing by aligning incentives within the group. However, if an insurer limits its investment targets to businesses within the insurance value chain, the available universe of businesses remains structurally limited. To acquire businesses that can grow to a sufficient scale to offset a future decline in underwriting profit, insurers need to expand the investment universe beyond the existing insurance value chain.

What criteria should insurers use when selecting businesses beyond adjacent areas?

When insurers move beyond the insurance value chain into independent non-insurance businesses, what criteria should they use to select target businesses? This report proposes three criteria.

The first criterion is that the target must already be an established business with meaningful scale or a clear ability to grow. The purpose of this proposal is to establish businesses that can provide stable sources of earnings for insurers in the future. Insurers should therefore focus on businesses that already generate stable cash flow, rather than starting uncertain new businesses or investing in start-ups to seek capital gains. The proposal does not assume that one business will provide all the required earnings. It assumes that the insurer will build a portfolio of several businesses that together provide earnings on a meaningful scale.

The second criterion is that the insurer must have room to increase the target business' value by using its core capabilities other than risk-taking. The insurer, as the corporate parent, should provide more than capital. It should use its own strengths directly to improve the target business's competitive position. For example, an insurer can use its broad sales channels to expand the distribution network of an acquired non-insurance service. A less obvious example is an insurer with an auto warranty business acquiring a tire wholesaler. The insurer can use its existing dealer channels and vehicle repair data to increase the tire wholesaler's market share. This business would be one part of the non-insurance portfolio. A majority investment is more suitable than a commercial partnership or minority investment when the insurer needs control to apply its core capabilities and increase the likelihood of realizing synergies.

The third criterion is that the acquisition should not be made mainly to increase insurance sales through cross-selling. After acquiring a non-insurance business, it may appear reasonable for the parent to give priority to selling its own insurance products to the target business's customers. However, on a platform or marketplace, giving priority to the parent's products can damage the trust that customers and participating companies place in the target business's neutrality. This can reduce the value of the business itself. The purpose of this strategy is to grow the target business as a stand-alone business. The insurer should not make insurance cross-selling the main objective of diversification.

This report defines Insurance-capability-led ownership as a model in which the insurer selects businesses that meet these three criteria, provides its core capabilities to them, and leads the actions required for the target businesses to use those capabilities.

How should insurers invest in and manage businesses when they do not have industry expertise?

The diversification of investments proposed in this report are fundamentally different from minority investments made as part of an insurer's general investment portfolio. They are business investments in which the insurer acquires a majority interest, secures management control, and leads the target business's strategic direction and value creation. The insurance industry already has examples of firms that used long-duration capital and float generated by insurance operations to make majority investments and build successful diversified groups. This report identifies two existing ownership models.

The first is the Capital-led ownership model seen at Berkshire Hathaway.^{5,6} Berkshire acquires strong businesses at appropriate prices and holds them for the long term. In this model, the corporate parent focuses on two roles: capital allocation and the selection and evaluation of managers. The parent collects excess cash generated by its subsidiaries and reallocates it to the opportunities with the highest expected returns across the group. In return for this central allocation of capital, the parent does not intervene in the subsidiaries' operational decisions.⁶ The governance of subsidiaries is also simple and centers on financial reporting to the parent.

The second is the Owner-led stewardship model seen at Fairfax.⁷ As an owner, Fairfax mainly participates in the selection of managers, capital policy, and decisions at strategic milestones such as mergers and acquisitions. Its historical success has been supported by a decentralized structure that gives management teams autonomy. Fairfax allows subsidiaries to use their earnings for reinvestment and bolt-on acquisitions. Fairfax also states that it is fervently attached to its decentralized philosophy and that this structure 'will never change.' These two models differ in their treatment of cash flow and governance mechanisms. However, both generally avoid intervention in the daily operations of their subsidiaries.

Insurance-capability-led ownership also leaves the daily operations of the target business to its management team. The corporate parent, however, participates in strategic decisions, including the selection of managers, capital allocation, mergers and acquisitions, and divestments. In addition, the parent provides its core capabilities other than risk-taking to the target business and leads the actions required for the target business to use them. This limited intervention is the main difference between this model and the two existing models.

To make this limited intervention successful, the parent needs to select capable business managers, share the group's principles, and establish people and governance arrangements based on parenting advantage.⁸ The people sent by the parent must fit the improvement opportunities and needs of the target business. A parent that lacks industry knowledge should not send generalist managers only to control budgets or monitor operations. Such appointments can distort operations and destroy value. The parent should send only specialists whose role is to carry out the actions required for the target business to use the parent's core capabilities and create synergies.

For governance, the parent should appoint managers with relevant industry expertise to lead the target businesses. It should also create a regular forum in which managers from different group businesses explain their businesses and hold one another accountable. Because these managers work in different industries and do not share the same technical language, the forum should require them to explain their businesses using general business logic. This improves transparency across the group. The same peer-accountability mechanism can also reduce the risk that an insurance parent with limited

industry knowledge will impose insurance-specific language or unsuitable performance measures on a subsidiary and direct the business in the wrong way.

Conclusion

Even if the conditions supporting risk-taking change and stable underwriting profits become more difficult to earn, the social value of insurance does not disappear. Insurers should not simply withdraw from the risk-taking business. They should continue to seek ways to make it sustainable. As one way to support this goal, this report proposes Insurance-capability-led ownership. Under this diversification model, insurers use core capabilities other than risk-taking to build an independent profit base through non-insurance businesses. Today's insurers, and those of us who work in them, must develop and implement this model.

Recommendations to the International Insurance Society (IIS)

The International Insurance Society can support the development of Insurance-capability-led ownership in three ways.

First, IIS should create a system to collect and share, in a common format, case studies of insurers entering non-insurance businesses around the world. IIS should also make this topic a theme for future conferences. This initiative would be particularly useful because insurers often provide limited public information about their non-insurance businesses.

Second, IIS should lead policy discussions on regulatory issues, including restrictions on the types of businesses that insurance groups may own and disadvantages under capital requirements. These discussions should consider how unnecessary restrictions can be reduced while maintaining appropriate policyholder protection.

Third, IIS should establish a management development program for insurance professionals who are responsible for businesses outside the insurance industry. Complementing general Executive MBA programs, this program could use participants' shared knowledge of insurance as a starting point and help them develop the skills required to evaluate, govern, and increase the value of businesses in other industries.

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