

# Global Trends in Life Insurance: Policy Administration

**Key policy administration trends and their implications for the life insurance industry**

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# 1 Highlights

The global life insurance industry witnessed a growth in 2010, mainly in the Asian region. The growth trend is likely to continue in 2011, although profit margins are expected to remain under pressure. Regional differences exist, with emerging markets growing at a faster rate than mature markets.

The life insurance industry is witnessing shifting trends in the front-office, policy administration, and claims, the three core functions of the insurance value chain. This paper identifies key emerging trends in the policy administration function of life insurance firms.

Life insurance firms remain challenged by their inflexible legacy policy administration systems. Designing innovative products, faster time to market and leveraging modern technology for multi-channel distribution has become essential for life insurers. Hence insurers are looking for policy administration transformation to enhance their operational efficiency with a lower total cost of operations by consolidating their existing systems.

Life insurance industry is also witnessing a shift from in-house package development or customization towards vendor-supplied packages that require minimal modifications. Consequently, they can reduce cost, improve efficiency, and react to changing regulations by leveraging the best practices offered by such vendors. However, a high cost of consolidation or vendor-supplier package may limit the focus to new business and products while managing the legacy business with already implemented systems.

The policy administration function is also experiencing a shift towards outsourcing. Outsourcing of policy administration processes can allow life insurers to focus more on the core activities of sales and marketing, underwriting, and asset management. However they may face the risk of overdependence in case they choose a single vendor for outsourcing.

Life insurers are also looking to leverage growth prospects in the emerging markets of Asia and Africa. It is imperative that their policy administration solutions should be able to support the cultural and product diversity, multiple distribution channels, region-specific regulations, and general operational requirements arising from operations across countries.

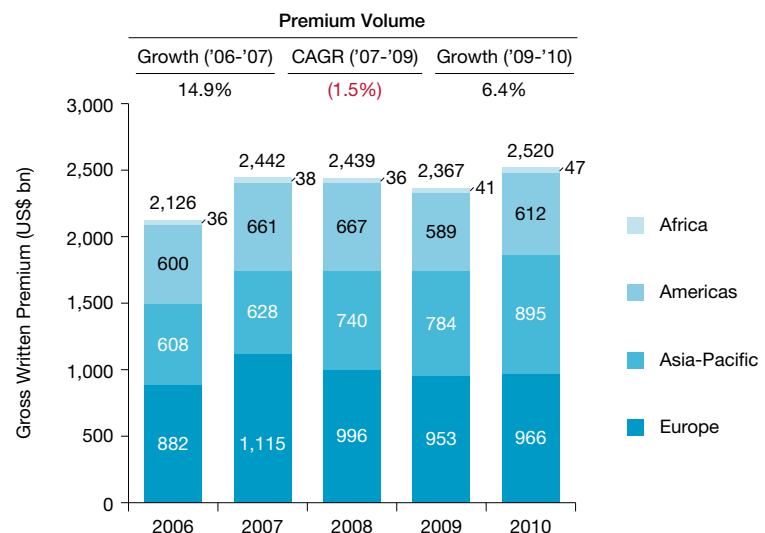
## 2 Introduction

### 2.1. Global Life Insurance Performance

The global insurance industry witnessed a positive growth of 2.7% (in real terms) of premium volumes during 2010<sup>1</sup>, after experiencing a decline during both 2008 and 2009. The return to growth in 2010 was largely a result of increased demand for insurance due to initial economic recovery across the globe. Looking to 2011 and 2012, the insurance industry is expected to witness a further growth in volume, though the uncertain outlook for further economic recovery will be a key determinant.

Global life insurance premiums grew by 6.4% in nominal terms (3.2% in real terms) to reach \$2.5 trillion in 2010. This increase was mainly driven by the growth of life insurance in Asia, which grew by 13.7% (in nominal terms)<sup>2</sup> and contributed over one third of total global premium volumes in 2010.

**Exhibit 1: Global Life Insurance Premiums (in US\$ bn), 2006–2010**



Source: Sigma Reports 2007-11, Swiss Re

The Latin America and Caribbean region witnessed the highest nominal growth rate of 29.1% in 2010<sup>2</sup>, although the contribution to total global volume remained minimal. The U.S. and U.K., two of the largest insurance markets, continued to experience a decline in life insurance premium volumes in 2010, although at a reduced pace compared to 2009.

However, while global life insurance premium volume has surpassed its 2007 peak, Europe and the Americas remain far below the 2007 levels. 2010 growth rates also do not match up to pre-crisis levels, and during 2007-2009 global life insurance premiums actually fell 1.5% annually due to the negative impact of the financial crisis.

<sup>1</sup> Sigma Reports 2007-11, Swiss Re

<sup>2</sup> World Insurance in 2010: Sigma Report, Swiss Re, 2011

Nonetheless, premium volume growth is likely to continue in 2011, based on further economic expansion in emerging economies and the increasing demand for life insurance products due to an aging population globally. However, life insurance firms' profitability is expected to remain below the pre-crisis level, primarily due to a lower investment return environment and increasing regulations that are encouraging clients to shift to less risky portfolios. Firms therefore need to find ways to differentiate across both their top and bottom lines.

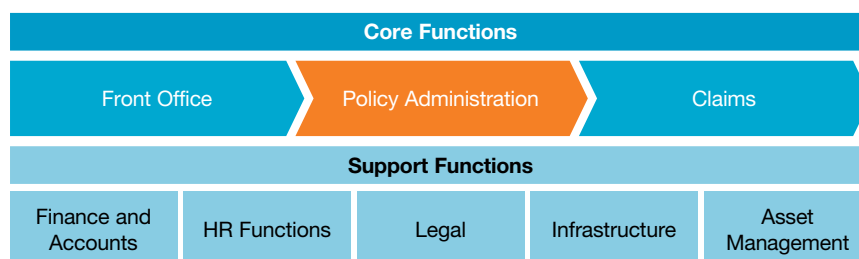
## 2.2. Insurance Value Chain

Insurance firms' operations can be broadly divided into three core elements, representing a value chain:

- Front Office
- Policy Administration
- Claims Processing and Payout

Along with these three core elements, a range of support functions are also required to ensure smooth operations of insurance firms, such as finance and accounting, HR, legal, infrastructure, and asset management.

**Exhibit 2: Insurance Value Chain**



Source: Capgemini analysis, 2011

This paper focuses on the policy administration function of the insurance value chain for life insurers.

# 3 Emerging Trends in Life Insurance: Policy Administration

Life insurers across the globe are looking for better growth and profitability. Unfortunately, their legacy policy administration systems have been largely inflexible and unable to adapt to constantly changing market dynamics.

As life insurers launch multiple new products, time-to-market has emerged as an important factor in remaining ahead of the competition. Leveraging multiple distribution channels and managing a diverse product range are other important drivers in the need for transformation of the policy administration function. Regulatory compliance has also become more critical due to changing regulations and global expansion. The life insurance industry is increasingly looking for vendor packages and outsourcing to control cost and leverage best practices.

These changes have led to an increase in the following key trends related to policy administration for life insurance firms globally<sup>3</sup>:

- Consolidation of policy administration systems.
- Adoption of vendor packages for policy administration.
- Outsourcing of policy administration functions.
- Need for a policy administration system that supports a global expansion strategy.

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<sup>3</sup> Trends shown are not necessarily comprehensive, but have been highlighted due to their relevance and potential impact on the industry

# 4 Trend 1: Consolidation of Policy Administration Systems

## 4.1. Background and Key Drivers

Life insurers continue to use multiple legacy systems to support their policy administration operations and product offerings. Most are looking to consolidate multiple systems, largely driven by the following factors:

- As life insurers seek to launch new and innovative products, they need faster speed-to-market for these products.
- Multiple policy administration systems offer different interfaces to business users, making it difficult to understand and interact with the process.
- Life insurers also face issues with the data consistency and redundancy due to the existence of information across multiple repositories in the organization. This lowers customer satisfaction since it results in customer service inefficiencies.
- The old legacy systems have limited flexibility, sometimes due to hard-coded logic, which results in a challenge in the case of any new requirement or change in business rules and processes.
- A streamlined approach to IT and business processes simplifies IT maintenance and business processes, resulting in lower costs and improved operational efficiency.
- Life insurers are increasingly leveraging multiple distribution channels, including direct networks such as the internet and indirect channels through brokers. An integrated policy administration system allows insurers to effectively utilize these disparate channels.
- The consolidation of an insurer's policy administration system reduces the number and types of interfaces and systems, which helps lower the training costs for new employees.

## 4.2. Analysis

As life insurance firms, especially across North America, become increasingly aware of the negative issues resulting from multiple policy administration systems, they are looking to consolidate policy administration systems in order to improve efficiency. They are taking a more strategic approach towards IT investments by investing in a single consolidated policy administration system (PAS) rather than maintaining multiple systems.

Insurers are exploring options to reduce the number of their policy administration systems to a single or a few systems based on their size of book of business and business needs. For example, a large life insurance group may consolidate to only two systems—one each for its individual and group policies—while a medium-sized insurer may opt for a single policy administration system.

Consolidation offers several key benefits to an insurance firm. Cost reduction and improved productivity are the key benefits as the process becomes streamlined. Consolidation also helps to improve sales volume as the firm is able to integrate its different distribution networks more effectively and agents/brokers spend more time in selling activities rather than dealing with multiple interfaces.

Since the consolidation of policy administration systems is a costly activity, implementation planning plays a key role in supporting success.

With consolidation, the insurer can offer an enhanced buying and service experience for the customers. It also helps to meet the new regulatory compliance for multiple product lines while reducing the time consumed in the process. Thus, an integrated policy administration system helps a life insurance firm to remain competitive and cost efficient.

**Exhibit 3: Benefits and Costs of Consolidating Policy Administration Systems**

Benefits	Costs
Reduced costs	Initial assessment
Improved productivity	System enhancement
Growth in sales volume	Product license
Improved customer service	Additional development
Effective compliance management	Additional infrastructure

Source: Capgemini analysis, 2011

However, insurers must consider the significant costs associated with the consolidation activity. The assessment of existing systems involves a significant initial cost, including feasibility and cost-benefit analysis. The implementation requires investment for enhancement of existing systems, purchase of new product licenses and solutions, additional component development, and infrastructure improvements. As the consolidation activity requires a significant investment, life insurers may continue to use legacy systems for existing business and products such as closed book business.

### 4.3. Implications

Life insurers should understand the following while consolidating their policy administration systems:

- Companies should analyze existing systems to decide the specific components for retention, or replacement, or enhancement.
- Insurers need to carry out an assessment of the existing portfolio of systems and the business imperatives to choose the right vendor and consolidation partner based on potential requirements.
- Cost-benefit analysis should be conducted before making the go/no-go decision on whether to make the investment in systems consolidation.
- There should be a migration strategy in-place for data from old systems to the consolidated new systems.



# 5 Trend 2: Adoption of Vendor Packages for Policy Administration

## 5.1. Background and Key Drivers

As life insurance companies look to reduce expenses, many are turning to outside vendors for policy administration. The business drivers leading to a preference for vendor-supplied policy administration packages are:

- Packages from vendors have continued to evolve according to changing industry requirements. They also benefit from lessons learned in past implementation experiences across various insurers, advancements in technology, and the changing customer preferences.
- Life insurers struggle to keep their in-house implementations updated as it requires significant maintenance costs.
- Prebuilt policy administration systems with good product definition capabilities can significantly reduce the time and effort involved in rolling out new products to the market.
- Regulatory requirements such as Solvency II are expected to drive life insurance providers to improve risk management frameworks, and reporting capabilities.
- Custom-built policy administration systems usually involve a significant cost and effort to keep the systems updated and in compliance with the latest regulatory requirements and business rules.

## 5.2. Analysis

Over the years, life insurance firms have adapted their policy administration system strategy according to changing business conditions. From the 1970s to the early 1990s, life insurers generally focused on building their own policy administration systems. By early 1990s, the firms realized that their systems were immature and not flexible enough to support new product types, deal with changing regulatory requirements, and incorporate new technology improvements<sup>4</sup>. In the late 1990s and early 2000s they began to customize vendor solutions according to their specific business processes and requirements. In the last few years, insurers have begun implementing vendor-supplied packages without any significant customization.

There has been an increasing trend, especially among North American life insurers, towards the deployment of out-of-the-box<sup>5</sup> functionalities of vendor policy administration packages. Life insurance firms have been shifting away from the traditional approach of developing their own policy administration systems or customizing the vendor-supplied system according to the internal processes.

**In the last few years, insurers have begun implementing vendor-supplied packages without significant customization.**

<sup>4</sup> *Three Megatrends Changing North American Life Insurance Policy Administration Systems*, Gartner Research, 2010

<sup>5</sup> Use of more out-of-the-box functionalities refers to the tendency to utilize the provided features and business process in the solution, instead of an attempt to change and customize them

Life insurers increasingly looking to use more out-of-the box functionalities from vendors and in some cases realigning their own business processes according to the functionalities provided by external software solutions. Such a change in strategy may help insurers to focus on their business since the vendor is expected to upgrade its packaged solution according to the new business needs and regulatory environment. This approach allows life insurers to reduce the cost of systems upgrades and customization.

However, such an approach may lead to overdependence on the solution provider to keep pace with changes, and would need to be guarded against. Also, a high upfront investment requirement for vendor-supplied package may limit life insurers to implement them for the new business and products. The legacy business, such as closed book, may continue to be supported by the existing legacy systems.

### **5.3. Implications**

Life insurers need to develop a strong vendor management function to manage the process of package and vendor selection and implementation. Insurers may increasingly need to look to vendors who are expected to make significant investment in policy administration systems for life insurance, so that the implemented package remains updated according to changes in the market or regulations.

A further implication may be an increased level of partnership between solution developers and life insurers in order to develop robust policy administration packages.

# 6 Trend 3: Increased Outsourcing of Policy Administration Functions

## 6.1. Background and Key Drivers

Policy administration remains one of the least outsourced insurance functions, especially when compared to claims and underwriting. Life insurers are increasingly looking to outsource their policy administration function in order to control costs and remain competitive.

The key drivers leading to the growth of outsourcing in policy administration are:

- Policy administration outsourcing may lead to significant cost savings for life insurers. Global sourcing and economies of scale allow business process outsourcing providers to achieve a lower cost-per-policy to administer policies than insurers with in-house operations. Additionally, outsourcing allows insurers to convert from fixed costs to variable costs which can lower overall operating expenses.
- Life insurers can focus on their core competencies of sales and marketing, underwriting, and asset management by outsourcing functions such as policy administration.
- Outsourcing vendors focus on designing, implementing, and operating the most efficient processes. Life insurers benefit from their best practices to improve the policy administration process.
- Alternatives to outsourcing the policy administration function could be reengineering the existing in-house implementation or replacing the implementation with an advanced policy administration system. However, both these approaches require large upfront investments.
- Life insurers may take advantage of the new opportunities provided by various emerging technologies by leveraging the competencies provided by the outsourcing partners. These include cloud-based offerings and Policy Administration as a Service.

## 6.2. Analysis

Life insurers usually have a higher operational cost of policy administration functions as compared with non-life insurers, mainly because life insurance policies have a longer life cycle than non-life insurance policies.

As life insurers continue to remain under profit margin pressure they are looking to reduce their overall cost. Furthermore, due to competition, insurers are not keen to risk brand deterioration by significantly reducing their sales or marketing activities. The policy administration function might therefore be the ideal candidate for outsourcing, as may be performed by a third party at a lower overall cost.

**Life insurers usually have a higher operational cost of policy administration functions as compared with non-life insurers, mainly because life insurance policies have a longer life cycle than non-life insurance policies.**

**Insurers are increasingly realizing that outsourcing decisions need to shift from a pure cost savings focus to a more holistic business transformation approach.**

Thus, an increasing number of life insurers are interested in outsourcing of their policy administration function, especially in mature markets like North America and Europe. Also, the outsourcing is witnessing a shift from component- or process-based outsourcing to transformational outsourcing<sup>6</sup>. Traditionally, insurance firms outsourced only a few components of their business process to business process outsourcing providers, such as the call center or the data entry component. This gradually evolved to process-based outsourcing, where the insurance firms defined and controlled their business process and the business process outsourcing vendors followed them.

However, insurers are increasingly realizing that outsourcing decisions need to shift from a pure cost savings focus to a more holistic business transformation approach. A business transformation outsourcing approach can lead to long term strategic benefits to insurers. As the vendors are expected to evolve their offerings to achieve better efficiency and keep their solutions updated with any regulatory changes, insurers would achieve the dual benefits of cost and process improvement.

Despite the benefits, outsourcing to a single vendor may lead to a risk of overdependence and also expose insurers to potential risks of overpricing. Thus, the life insurers may go for a multi-vendor outsourcing strategy. However the multi-vendor outsourcing may also lead to potential risk of vendor lock-ins and loss of control on business continuity. But the benefits are numerous and, if well-planned, can exceed any potential risk.

### **6.3. Implications**

Life insurers are expected to take a more long-term view of outsourcing by focusing on multi-year business transformation-focused engagements with vendors. Vendor selection and management therefore becomes the key determinant of success. A poor vendor choice can impact customer service, leading to customer attrition and loss of business.

Insurers also need to conduct due diligence by evaluating each vendor's technical expertise, past success in the insurance sector, and service-level agreements. Cost would also play an important role in the selection. The outsourcing vendors themselves are also expected to leverage their domain and implementation experience to develop value-based offerings for their life insurance clients.

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<sup>6</sup> Transformational outsourcing occurs when a customer's business function is re-engineered so that both the performance improves and the cost decreases

# 7 Trend 4: Need for Policy Administration System that Supports a Global Expansion Strategy

**A growing number of global insurers are entering emerging markets, especially the Asia Pacific region which is growing at a much faster rate than North America and Europe<sup>7</sup>**

## 7.1. Background and Key Drivers

Life insurers are looking to expand beyond their domestic region to tap markets which provide better growth opportunities. The majority of insurers are planning to expand internationally with growth and profitability the main drivers for global expansion. A growing number of global insurers are entering emerging markets, especially the Asia Pacific region which is growing at a much faster rate than North America and Europe<sup>7</sup>.

Africa also offers significant potential for growth, as the life insurance penetration remained significantly lower than the global average. Life insurance premium volume in Africa was 2.7% of GDP in 2010, while global life insurance premium volume was 4.0% of GDP the same year<sup>7</sup>.

This cross-border expansion is leading to a need for policy administration solutions which meet various region-specific requirements.

## 7.2. Analysis

As foreign insurance firms enter a new geography, they face both business- and IT-related issues. These issues are largely due to the different market conditions in terms of degree of maturity, distribution channel preference, insurance product preference, regulations, and consumer behavior.

Hence, insurers' policy administration solutions need to support the difference in product types, features, and distribution channels, while supporting various general requirements of cross-border business operations.

The product range and features usually differ based on the customer preference in a particular geography. The policy administration solution needs to support region-specific features and diversity of offerings required for emerging markets. For example, when entering markets with a significant Muslim population—such as the Middle East, Malaysia, and Indonesia—insurers must support Takaful<sup>8</sup> products. Similarly, life insurers looking to grow across countries in Africa and South Asia may plan to offer micro-insurance<sup>9</sup> products. A policy administration solution must support such regional products while maintaining performance, scalability, and ease of user interface.

As the distribution mix changes according to customer and regional diversity, the policy administration solutions should help the life insurer to leverage this diversity in an effective manner.

**As the distribution mix changes to support customer and regional diversity, policy administration solutions must help effectively leverage this diversity**

<sup>7</sup> World Insurance in 2010: Sigma Report, Swiss Re, 2011

<sup>8</sup> Takaful is an insurance type based on Shariah, Islamic religious law, and founded on the principle that it is the responsibility of individuals to cooperate and protect each other.

<sup>9</sup> Micro-insurance refers to insurance products for low income households that offer low premium rates with lower level of coverage.

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**Exhibit 4: Support Required from Life Insurance Policy Administration Solutions**

Source: Capgemini analysis, 2011

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The required support of different regional regulations leads to significant implications for the policy administration system. Life insurers need to ensure compliance to all regulation and reporting requirements.

Policy administration solutions also need to consider the general operational requirements arising out of global operations, such as multiple language and currency support, different modes of payments, and renewal reminders offered through a client's preferred medium. Also, 24x7 availability of customer service becomes an important factor.

**Life insurers may need to look for region-specific vendors to support local operations... or IT service vendors that have capabilities that can address the multi-lingual, multi-currency and multi-regional needs of their insurance customers.**

### 7.3. Implications

Firms need to analyze the product, distribution, customer service needs, and regulatory requirements of their target markets and assess the level of support provided by their current policy administration systems. They need to assess potential gaps and understand the required changes for global support.

While doing so, insurers also need to anticipate their future business operational model, and decide if they want to implement centralized or decentralized enterprise architecture while implementing a policy administration solution.

Life insurers may need to look for region-specific vendors to support their local operations. Availability of near shore services might be very helpful from the operational perspective. But then the local vendors are usually expensive. Hence insurers would probably look for those IT service vendors that can provide customized services based on the needs or have capabilities that can address the multi-lingual, multi-currency and multi-regional needs of their insurance customers.

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