Global Trends in Life Insurance: Policy Administration and Underwriting

Key policy administration and underwriting trends and their implications for the life insurance industry
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1. Highlights

After growing in 2010, global life and pensions (L&P) premium volumes contracted by 2.7% (real terms) in 2011, slipping back into the red. However, performance was not the same across all regions. North America and Asia witnessed positive real growth, while Europe saw a negative real growth. Profitability also suffered, as lower than average interest rates and volatile financial markets negatively impacted the profits of L&P insurers in 2011.

Going forward, global L&P industry growth is projected to remain sluggish in advanced economies, while the premium growth is expected to improve in emerging markets. Recovery is predicted to be slow in the U.S. and economic challenges are expected to continue in Europe due to the protracted sovereign debt crisis. Asia and Latin America, however, are predicted to continue their growth on account of strong domestic demand.

Currently, the key trends driving a change in policy administration and underwriting function are:

- Increasing use of business process outsourcing (BPO) for closed-book operations
- Increasing adoption of self-service for policy servicing
- Enhanced use of business intelligence and analytics for underwriting

Globally, an increasing number of insurers are moving their closed-book operations to BPO to gain operational efficiencies. As non-core tasks are moved to external vendors, insurers can shift staffing to more value-added activities.

In addition, insurers are trying to increase self-service adoption to improve profitability and customer service effectiveness as an increasing number of Gen X and Gen Y customers1 are using self-service to maintain their insurance policies.

Finally, life insurers are quickly realizing the power of using big data to understand performance levels and trends in their underwriting practices and therefore investments in business intelligence (BI) and analytics are rising.

1 Gen X and Gen Y customers refers to the customer in the age group of 18 to 49 year old
2. Introduction

2.1. Global Life Insurance Performance

The growth in the world economy slowed down again in 2011 after the post-crisis recovery seen during 2010. In 2011, global real GDP growth weakened to 2.7% compared to 4.1% in 2010. This slowdown had a negative impact on the global insurance industry and direct premiums dropped by 0.8% in real terms—mainly due to a decline in the life insurance industry. The near term future still looks uncertain for the global insurance industry due to the ongoing economic challenges in Europe. However, emerging markets are expected to continue their growth, though at a slower rate, while North America is expected to witness moderate growth.

While the North American insurance industry did well in 2011, Europe witnessed a steep decline in premiums due to the sovereign debt crisis. In North America, life premiums in real terms grew for the first time since 2007, rising 2.3% on improving economic conditions. On the other hand, premiums in Europe fell drastically by 9.6% in 2011 and declines were observed across the board in Western Europe.

Asia, which recorded the highest growth in 2010—6.9% in real terms—slowed in 2011, recording only 0.5% growth, as China and India put a drag on growth. After growing strongly in 2010, premium volumes in emerging markets declined by 5.1%, real terms, in 2011, due to steep premium drops in China and India in the wake of regulatory changes that restricted the use of certain distribution channels.

Growth has also been affected by the steady lapsation rates over the last 10 years which have created serious persistency problems for the global life insurance industry. Insurers are facing difficulty in coping with low persistency, leading to high lapsation rates.

Exhibit 1: Global L&P Insurance Premium Volumes ($ billion) and Inflation-Adjusted Growth (%), 2007-11

<table>
<thead>
<tr>
<th>Year</th>
<th>GWP ($ bn)</th>
<th>Inflation Adjusted Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2,442</td>
<td>5.1%</td>
</tr>
<tr>
<td>2008</td>
<td>2,439</td>
<td>(5.8%)</td>
</tr>
<tr>
<td>2009</td>
<td>2,367</td>
<td>(0.8%)</td>
</tr>
<tr>
<td>2010</td>
<td>2,516</td>
<td>2.9%</td>
</tr>
<tr>
<td>2011</td>
<td>2,627</td>
<td>(2.7%)</td>
</tr>
</tbody>
</table>

Source: Capgemini Analysis, 2012; Swiss Re Sigma Reports, 2008-12

4 Latin America, central and Eastern Europe, South and East Asia, the Middle East (excluding Israel), Central Asia, Turkey, and Africa
5 Persistency in life insurance is defined as the percentage of policies in force at a particular time
pressure on revenue generation. The financial management of insurers is negatively impacted due to lapses by policy holders, and this trend has led to costlier policies for customers and, in turn, affects overall revenue growth.

Overall profitability of the industry also remained under pressure as the lower-than-average interest rates continued in 2011 and weighed on insurers’ investment results. These low rates combined with volatile financial markets negatively impacted the profitability of L&P insurers in 2011. Interest rates continued to decrease in North America and several western European economies hurting investment income, while financial markets, after performing solidly in the first half of 2011, became more volatile during the second half due to the European sovereign debt crisis and deceleration in global economic growth.

Going forward, the global L&P industry growth is expected to remain sluggish in advanced economies, while the premium growth is expected to resume in emerging markets. Recovery is expected to be slow in the U.S, while economic challenges in Europe are expected to continue on account of the protracted sovereign debt crisis. Asia and Latin America, however, are expected to continue their growth due to strong domestic demand.

2.2. Insurance Value Chain

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

- Front Office
- Policy Administration and Underwriting
- 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, 2012

This paper focuses on the policy administration and underwriting function of the insurance value chain from a life and pensions perspective. We identify key trends in this area and the potential impact of these trends on the performance of global life and pensions industry.

6 North America, Western Europe (excluding Turkey), Japan, Hong Kong, Singapore, South Korea, Taiwan, Oceania, and Israel

Gross written premiums (GWPs) are starting to recover from the declines at the height of the financial crisis, but growth is still weak overall—especially in industrialized markets. To protect and grow profits in this environment, insurers are focusing on capturing efficiencies, especially in the policy administration and underwriting area.

These changes have led to the emergence of the following key trends in the policy administration and underwriting area for life insurance companies globally:

- **Increasing use of BPO for closed-book operations:** Insurers are moving their closed-book operations to BPOs to find operational efficiencies, as these operations are currently often maintained in legacy systems resulting in costly operations and maintenance challenges.

- **Increasing adoption of self service for policy servicing:** Insurers are also trying to increase self-service adoption to improve profitability and customer service effectiveness since an increasing number of Gen X and Gen Y customers are using self-service to maintain their insurance policies.

- **Enhanced use of Business Intelligence (BI) analytics for underwriting:** Insurers are quickly realizing the power of using big data to understand performance levels and trends in their underwriting practices and therefore the investments in BI and analytics are rising—and will likely continue to rise over the next five years.
4. Trend 1: Increasing Use of BPO for Closed-Book Operations

4.1. Background and Key Drivers

Globally, an increasing number of life insurers are looking for new options to reduce operational costs so outsourcing closed-book operations to BPOs is gaining momentum. Closed-book outsourcing is when life insurers and pension providers shift a block of policies, which are no longer being sold, to a third-party provider. The rationale for outsourcing closed-book operations is that these policies are non-revenue generating but are still prone to claims and servicing expenses and are often maintained in legacy systems which results in costly operations and maintenance challenges.

Closed-book outsourcing has become important among Tier 1 and Tier 2 life insurers as an opportunity to rid themselves of legacy systems where conversion is too expensive or risky. This outsourcing allows insurers to find operational efficiencies, and to shift resources to more value-added activities. Much of the interest in closed-book initiatives is driven by technology considerations, where companies identify BPO as an alternative to system replacement or modernization.

The important vendor qualification criteria that insurers should look for are: quality of services; cost of services; process adherence; and financial stability.

Exhibit 3: Most Important Considerations for Outsourcing Closed and Open Book Operations, 2012

Source: Capgemini Analysis, 2012; World Insurance Report 2012, Capgemini and Efma
4.2. Analysis

Closed-book operations can be problematic for companies as the business volume of these systems declines over time and is often maintained on legacy systems, resulting in high operational expenses and maintenance challenges. As companies rationalize their product portfolio and focus on improving the bottom-line through transformation initiatives targeting mainly the policy administration and underwriting areas, shifting closed-book operations to a BPO provides insurers an opportunity to get rid of some legacy systems. Outsourcers deliver value by focusing on the design, implementation, and operation of the most efficient processes for improving insurer profitability. As a result, insurers around the globe are becoming more comfortable outsourcing these operations.

However, insurers need to avoid overdependence on a single vendor which could expose them to potential risks of overpricing, vendor lock-ins, and disruptions based on operational failure. A badly managed closed-book outsourcing engagement could impact the servicing of existing end customers—leading to reputation loss in the market, increased customer attrition, and resultant revenue losses.

4.3. Implications

Closed-book BPO will continue to be important among life insurers over the next couple of years, with more deals signed, especially in North America. Overall, BPO adoption rates around the globe vary. The U.K. is currently the most mature in outsourcing closed blocks to other locations, while many markets have no adoption for closed-book BPO at all. However, the global trend is that an increasing number of insurers are moving their closed-book operations to BPOs to find operational efficiencies, and to shift staffing to more productive value-added activities as tasks are moved externally.

- Insurers in life insurance, annuities, and pensions should consider BPO alternatives for closed-book processing, especially if running on legacy systems that are difficult and expensive to maintain, and where the products are not considered core to the business.
- BPO firms must demonstrate strong IT skills, domain competency, and operational expertise to support closed-book processing, as well as to support data conversion and required system maintenance and upgrades.
- There are many restrictions on moving data and policy holder information to locations beyond the geographical boundaries of a country. Insurers should watch for issues like depersonalizing the data and having in place adequate measures to handle privacy of policy holder information.

8 Depersonalizing the data refers to modification of personal data so that the information concerning personal or material circumstances can no longer be attributed to the customer or policy holder.
5. Trend 2: Increasing Adoption of Self-Service for Policy Servicing

5.1. Background and Key Drivers

In mature markets, where top line growth has been fairly flat, an insurer’s best bet to achieve margin improvements is by reducing operational costs. In a bid to decrease customer service costs, a majority of global insurers are increasingly providing self-service options to their customers, redirecting customer interactions from branch or call centers. Online self-service functionalities like online bill payment, checking policy information, or making policy changes online are also having a significant impact on customers’ choice of an insurance provider.

In addition to cost savings, mobile self-service is beginning to influence insurance shopping decisions and will serve as a key differentiator for insurance companies.

Also, as quotation and application functions at many leading insurance companies have been mostly optimized, insurers are moving on to post-purchase activities like self-service as a next step of automation. Finally, online self-service also provides a platform for cross-selling and up-selling, as insurers strive to improve customer retention by selling more products to existing customers.

However, online self-service in both North America and Western Europe is often characterized by limited promotion, inadequate content, lack of online functionality, and poor processes. Many insurance companies are still not aggressively promoting online self-service and therefore the rate of adoption, while growing, is still low. Another important reason for the relatively low adoption of self-service channels is the lack of personalized approach in interactions with the customers. Since the persistency of a life insurance policy depends on the relationship between the insurer and the policy holder, personal focus on the customer is still critical.

Exhibit 4: Key Drivers for Increasing Adoption of Self-service for Policy Servicing

Source: Capgemini Analysis, 2012
5.2. Analysis

Insurers, globally, are under pressure to improve operating profitability and reduce expense ratios. In this environment, online self-service provides tangible expense reduction and return on investment, as insurers can reduce costs, while improving customer satisfaction, by directing customers to the web, freeing phone lines to shorten wait times and providing fast online alternatives for customers who prefer self-service.

As an increasing number of Gen X and Gen Y customers are using self-service to maintain their insurance policies, online self-service continues to gain momentum in the insurance industry, but customer adoption remains low. Direct and agent-based insurers are struggling to increase adoption due to an array of challenges including: the infrequency of insurance interactions; some customers’ channel preferences; and limited functionality. However, there has been increased adoption of certain self-service activities like online bill pay which provide a solid business case for further online self-service.

5.3. Implications

Globally, insurers are trying to increase self-service adoption to improve profitability and customer service effectiveness while an increasing number of Gen X and Gen Y customers are using self-service to maintain their insurance policies.

In order to be effective, insurers have to fully integrate their online self-service into their overall policy application or purchase process across channels, providing a consistent and seamless post-purchase experience. However, due to data-related issues involving legacy systems and integration with modern systems, many insurance companies have not yet built the functionality required to promote online self-service.

Going forward, in order to improve expense ratios and differentiate themselves in an intensely competitive environment, insurers need to aggressively promote online self-service and address technical issues such as web site functionalities and data management.
6. Trend 3: Enhanced Use of Business Intelligence and Analytics for Underwriting

6.1. Background and Key Drivers

Global insurers are placing a lot of emphasis on data mastery using business intelligence (BI) to empower end users with the information required for better decision making. Data is one of the most important assets for a life insurance company; however, most companies do not derive maximum value from their data. At a global level, very few insurers have aggregated and cleansed data accessible to their end users for real-time or near real-time underwriting.

In order to improve profitability in an uncertain economic situation, insurers are demanding better insights and analytics for in-depth assessment of customer behavior, better risk management, improved underwriting accuracy, and fraud detection.

Focusing on improved data management and preparing for “big data” requirements, will be key for life insurers during the next few years. Insurers unable to leverage data assets will be at a significant disadvantage against competitors who have greater insight into customers, products, performance and underwriting risks.

Exhibit 5: Drivers for Enhanced Use of Business Intelligence and Analytics in Underwriting

Source: Capgemini Analysis, 2012

9 “Big Data” refers to to large and complex data which becomes difficult to handle using existing database management tools
6.2. Analysis

In a rapidly changing market, life insurance companies worldwide are focusing their energies to become an informed enterprise. BI and analytics provide a consistent data foundation that provides a single view of a customer in an accessible manner. Global insurers are focusing on collecting, storing, and analyzing quality data to gain valuable insight into customer behavior, improve risk management and underwriting, and detect fraud and risk patterns.

BI and analytics will significantly help life insurers speed up and control underwriting costs, while providing improved experiences to the customer and the agents. Innovative and visionary life insurers are increasingly adding more BI and analytics capabilities in order to gain heightened intelligence into operational, customer, and underwriting trends, as well as to improve their regulatory reporting capabilities.

Having more-powerful analysis capabilities will aid life insurers in risk management, improved underwriting profitability, and better customer intelligence—including customer segmentation, life stage analysis and profitability metrics—and also allows insurers to have aggregated and cleansed data to analyze and respond to new business needs in real time or near real time.

6.3. Implications

Turning data into business information through data warehousing—and leveraging it to improve profitability—is a growing trend in the insurance industry. Life insurers are quickly realizing the power of using data to understand performance levels and trends in their underwriting practices, and the investments in BI and analytics are therefore rising and are expected to continue to rise during the next five years.
References


5. Swiss Re Sigma Reports, Swiss Re, Published annually. Also available at http://www.swissre.com/sigma/

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About the Author

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