The Clarion Call of Business Process Outsourcing

A White Paper

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GeniSys is an international provider of market leading front and back-end policy administration services for the life and health insurance market. Utilizing experienced insurance professionals, refined business processes and best-of-breed technologies, GeniSys is able to provide substantial cost-savings and increased efficiencies for end-to-end policy administration services. For more information, visit http://www.genisysoutsourcing.com

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Background

Although the life insurance sector has been lagging behind other industries in outsourcing non-core business operations, it is now poised to take advantage of handing over their business processes to external experts. Business process outsourcing (BPO) gives life insurance firms access to the process efficiencies and cost effectiveness of best-of-breed partners that will allow them to grow and stay viable in a very competitive market. Business process outsourcing has now become too compelling for insurance carriers to ignore.

In the last decade, life insurance companies have endured market forces that have lowered their profit margins, reduced their economic returns, and weakened their competitive position. As a result, their performance has fallen behind other financial service sectors. The market forces that have had the most severe impact on life insurance companies are 1) deregulation, that has opened the floodgates to new entrants, such as banks and investment firms, 2) consolidation, that has intensified competition, especially among the mid-size insurance companies, and 3) technology, that has drastically changed the industry's way of operating in terms of selling, marketing, and customer interaction.

Meanwhile, the new geo-political global environment has resulted in new and complex risk protection requirements. In fact, the regulatory environment has become so complex and cumbersome that insurers struggle to keep up with the ever-changing requirements. This tough external environment is placing tremendous pressure on life insurers, providing strong impetus for them to re-assess their business model and take steps to adopt a new vision and approach.

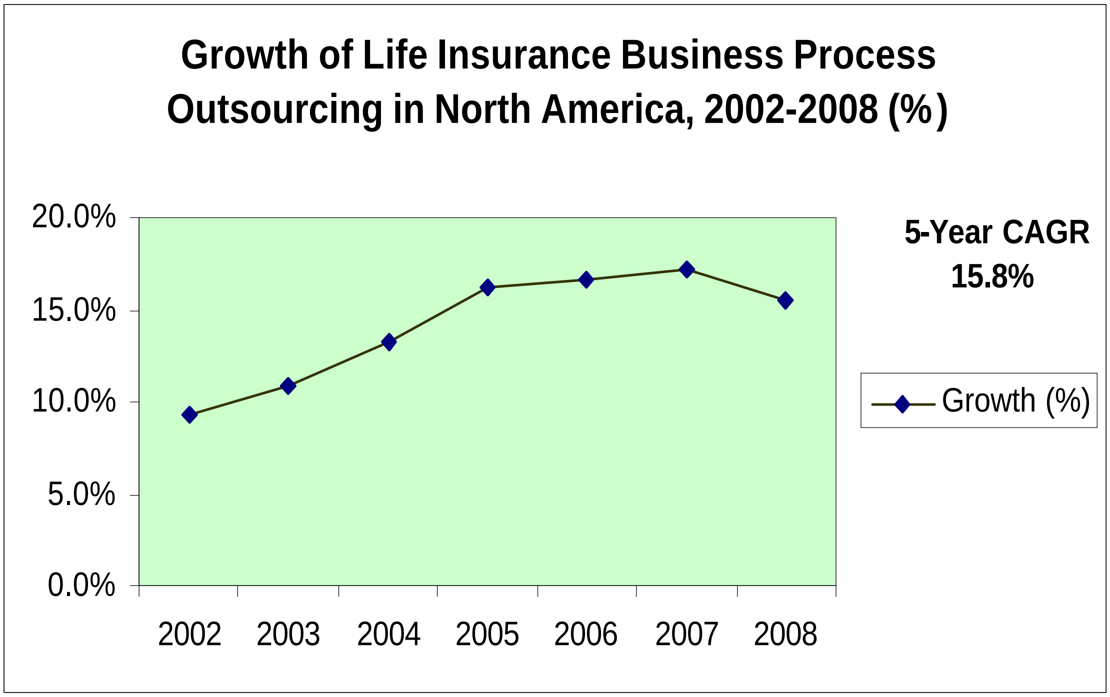
BPO Growth in North America

For many insurance executives, BPO is beginning to look increasingly attractive and compelling as a potential solution to their challenges. Many of them, the early adopters, have already begun to rely on service providers to handle some or most of their business processes. They are apparently following the advice of management guru, Tom Peters, who states, "Do what you do best and outsource the rest."

According to a 2003 study by IDC, a major market research firm, almost 12% of insurance companies interviewed were currently involved with some aspect of BPO, whereas another 5% were definitely planning to outsource in the coming year.

To be sure, BPO has been slow to catch on in the life insurance industry. Most observers would agree that because this industry is relatively risk-adverse and traditional, it has been lagging behind most other sectors in adopting outsourcing. However, according to analysts, this is changing and the demand for BPO services among life insurance carriers is picking up. Most analysts predict double-digit growth. The demand for BPO in the U.S. is projected to show a steady, upward trend from 2002 to 2008 with a 5-year revenue compound annual growth rate (CAGR) of nearly 16% (see below); according to

Datamonitor, the life insurance BPO market is expected to grow by as much as 17.6% between 2002 and 2006 in the U.S. (2).



What is BPO?
BPO involves the transfer of one or more complete business processes or entire business functions to an external service provider with special expertise to manage people, processes and technologies. The vendor "takes over" the day-to-day operation for a negotiated period of time.

The service provider becomes part of the decision-making structure with respect to the outsourced process or function and by being committed to certain deliverables is evaluated on a regular basis in terms of providing strategic business value. In other words, the outsourcer takes on the responsibilities as well as the risks for meeting its customer's requirements. Contracts can be performance based, where business value or performance is recognized through some agreed-upon business results like cost savings, increased productivity and operating efficiency, and improved customer service.

It is also important to note that information technology (IT) plays a large part in these BPO contracts. In order to optimize the value of a BPO arrangement, the service provider will implement new technologies and/or software applications to replace or supplement the existing IT infrastructure. This is often referred to as IT-enabled BPO.

Who are the BPO Clients?
An increasing number of insurers are turning to external experts. Whereas some of the very large insurers tend to outsource their entire back-office operation, which includes functions such as policy owner service, accounting, billing, and claims, other insurers

opt for a more tactical, ‘a la carte’ approach by outsourcing on a more limited basis (e.g. call center).

Some examples are:

- **Fidelity & Guaranty Life** - has outsourced a number of key business processes, including new business applications, underwriting, policy administration, claims processing, and customer service.

- **Sun Life of Canada** - decided to outsource the policy administration of its UK business.

- **Swiss Re -** signed a 10 year agreement to have certain back-office functions managed by an outsourcing provider.

- **Lincoln National (**third largest seller of variable annuities and seventh largest life insurance company on the basis of sales) – recently outsourced certain back office functions.

- **Unity Life of Canada - signed** a contract in 2000 with a service provider to process its new business and manage all in-force policies. As a result, Unity Life became a “virtual” insurance company.

Although the “early adopters” of BPO services primarily represent new businesses or large companies, the trend is now moving to mid-size companies as well. Eventually, BPO will be a prevailing business practice in the life insurance market – as it is in so many other industry sectors.

What Do Life Insurers Outsource?

IDC conducted a study of life insurance executives showing that they tend to be most open to outsourcing processes related to closed lines of business – policy administration and claims. Customer access is another operation that these executives outsource; about 40% said they outsource their call center, mail, and fax for closed, and in some cases open lines of business (1). Another recent IDC report finds that there will be a growing number of insurance carriers who will hand over their entire non-core business operations as opposed to just outsource “piecemeal” transactions (IDC report “Insurance Claims Processing in the U.S.,” March, 2004). As insurers experience the benefits generated by BPO, they begin to outsource more and more of their least strategic, non-core operations.

Why Should You Outsource?

The increasing demand for BPO among life insurance companies clearly indicates that this marketplace acknowledges the business benefits that can be derived from this type of service. The reasons why insurers are transferring some or all of their business operations to an external vendor are many and diverse; however, some of the most frequently mentioned factors are:

I: Cost Savings

Reduced operating costs through outsourcing is mainly achieved by relying on a service provider that has expertise in re-engineering the processes while utilizing best-of-breed, web-enabled technology, automation tools, and self-service to support the new process. And by taking advantage of labor arbitrage in near-shore locations, the service provider gains additional cost savings. For example, Sun Life of Canada, U.K. division, has reported a savings of $50 million from outsourcing its policy administration in one business unit. Insurers can typically realize an average of 20-30% savings in annual policy administration expenses.

II: Ability to Focus on Core, Strategic Issues to Unlock Business Value

By outsourcing basic, routine processes or operations that do not represent the core competence of an insurance company, management is freed up to manage those activities that generate the highest possible value. They are no longer bogged down in the day-to-day minutia of administering policies, but can redeploy resources to support new, higher margin initiatives in areas such as sales, marketing and new product development.

III: Fix the Old – Access to Additional Resources, Skills and Expertise

An outdated and aging IT infrastructure has become a significant drain on many insurance companies. In most cases, they need to completely overhaul their systems, a very costly endeavor requiring special skills and staff resources that may not be available. An outsourcer with IT expertise can release an organization from these constraints by taking on the responsibility for any needed technology upgrades to support a more efficient and cost-effective business operation. For example, an old servicing infrastructure is replaced with a utility that is based upon new technology, using Web-enablement for self-service among both customers and insurance agents. And other technologies like decision-support systems, data warehousing, data-mining and relational databases improve the capture and use of customer data. Besides IT skills, an outsourcer also frequently contributes industry expertise in implementing the most efficient and streamlined business processes.

IV: Improved Speed-To-Market with New Products and Services

Time-to-market with new products and services is a very critical issue among life insurance companies, with a lack of IT and other product-related resources the main reasons for delays. Outsourcing offers an advantage by allowing carriers to access outside life insurance-specific resources and expertise to get new products and services to market faster than what has otherwise been the case.

V: Strong Profit and Growth Signal to the Marketplace

> The movement away from non-core activities and redeployment of resources through outsourcing sends a strong growth and profitability message to the marketplace and capital markets. This in turn creates a competitive advantage that can help support further investments in new products and any expansion efforts, e.g. acquisitions.

A Testimonial

The following testimonial from a mid-tier Canadian life insurance carrier lends further support to the significant benefits that can be derived from a BPO arrangement. The Senior VP of Marketing of this company states:

"Partnering with a best-of-breed service provider for all life insurance policy administration services has allowed us to focus on managing and investing in what we do best – develop and sell insurance. Our top line premium income has grown by over 1,000% in the last 3 years ($2 million of new business premium in 2000 to $45 million in 2003). Our profitability is up 300% in the same time-frame. The result is that we are the fastest growing insurance company in terms of new business in Canada.

All key service levels, including policy issue times, call centre response rates, claims handling, etc. have improved significantly. We are also much more responsive to the need to enter new markets and introduce new products – our new product development cycle has gone from over 18 months to 6 months.

Finally, a variable costing structure has allowed us to reduce our fixed overhead expenses and unit costs resulting in highly competitive rates.

Our experience demonstrates that vision, execution and the right partners are a powerful combination."

What are the some of the key issues?

It is clear that BPO can provide significant value to insurers. However, there are many issues that must be considered before signing a contract with a service provider, including:

I: Basic versus More Complex Processes

What is to be outsourced? Non-core processes are the most obvious candidates for outsourcing, while the more critical are those with a customer interface, such as a call center. The question arises whether or not a provider's call center is capable of providing the depth of knowledge required to handle a large portfolio of highly sophisticated products. Another important question is if the provider has the capability or should be given the responsibility to resolve customer problems.

Many case studies have shown that service providers have the systems resources and process expertise to support even the most complex products and can provide seamless interfaces back to the company's own systems.

II: Vendor versus a Partner Relationship

Executives need to assess whether they are looking for a vendor to provide specific services for a fixed cost, or a partner relationship where a deeper, more intimate involvement is contemplated. In a partnership the parties develop a win-win environment in which the service provider has a strong sense of accountability to the client, striving to find new ways of adding value, as well as being flexible to meet changing needs. They develop a deeper understanding of the client's culture and business issues, enabling them to serve the client more effectively. The client contributes by being willing to pilot new solutions that the vendor may want to test.

A long-term view of the relationship strengthens the vendor's sense of commitment to the client and vice versa, which further enhances an overall sense of confidence as well as encourages cooperation and joint problem-solving. It is important to remember that outsourcing a function does not mean that you can forget about it.

III: Formal Governance and Communication Structure

Fear about loss of control can be a serious barrier to turning to an outsourcer for assistance. Change is difficult for many people, and handing over business processes to external providers can create a lot of concern and anxiety among insurance executives. This can become even more problematic if the leader of the business operation feels that his or her position is being threatened.

The best way of addressing this issue is to set up a formal governance and communication structure to ensure that the relationship remains productive and positive during the planning and implementation stages. It is also important to maintain regular interaction and communication with the vendor after the project is implemented. To ensure that this happens, there must be a communication plan stipulating how often meetings will occur and who is going to participate. A governance structure should also include dispute resolution clauses and a metrics tracking system to regularly evaluate performance and service-level agreements (SLAs).

IV: Conduct Quality Checks

One approach used by some insurance companies is to use their own internal auditors to manage and monitor process control and quality. Auditors will work on the provider's site, performing regular audits on applications, claims, call handling, and the management of suspense accounts. They may even conduct formal semi-annual assessments of different processes, such as underwriting and claims adjudication. One important reason for this approach is that it addresses the concern about ongoing data accuracy. The lack of data accuracy is often raised as an issue with outsourcers because it could result in poor decisions and perhaps even costly mistakes.

V: Use of Performance Metrics to Assess Progress and Business Performance
Vendor performance metrics are an integral part of outsourcing contracts in that they allow that both the carrier and vendor to check on the progress and evaluate the success of an outsourcing deal? Quantitative measures might include, for example, speed to process a policy, error rates in claims, and how long clients must wait to get a response from a customer service representative. Qualitative measure may involve a customer satisfaction survey to capture the intangibles. Rewards and even penalties can be tied to meeting (or not meeting) performance goals.

Conclusion

The most important issue to recognize is that BPO has become a legitimate strategy for carriers to utilize in order to remain competitive and viable in a tight competitive market.

However, executives need to ask themselves…

- Why do I want to outsource? A lack of clarity about the basic motivation to outsource can lead to the wrong outcome.

- What do I want to outsource? Having a solid understanding of your organization's culture, core competencies and resource capacity is key. And an examination of what other insurers are outsourcing provides a clue as to what the possibilities are.

- To whom do I want to outsource? Finding the right service provider is paramount. Sourcing advisors who consult to companies are one good source of information and guidance. Or, talk to executives of companies with outsourcing experience and ask them which BPO provider(s) they have had positive experience with.

Once these fundamental issues are addressed the keys are then execution and communication.

References:
1. IDC report #30312, "Customer Needs and Strategies: Customer Perceptions of Life Insurance BPO," November 2003.

2. Datamonitor, "BPO in U.S. Insurance," November 7, 2003.