



# Core Operations Modernization in the Global Insurance Industry

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# Summary

## In brief

The need to transform core operations environments is the most critical objective for many insurers if they are to compete effectively in a changing insurance market and be in a position to counter the threat posed by potential new entrants. To date, many insurers have taken initial steps toward becoming a "digital insurer" by implementing customer front ends. Although these initiatives are beneficial, they remain essentially isolated from the core operations environment and require significant custom systems development or manual intervention to interoperate to any real extent.

To understand the true state of core operations modernization within the global insurance industry, Ovum has undertaken one of the largest independent studies of its kind, conducting in-depth interviews with 530 senior insurance decision-makers. This independent research was conducted on behalf of SAP.

## Ovum view

- Most insurers continue to run multiple and fragmented core systems, with 41% of all carriers operating 11 or more core operations platforms, and 30% of carriers having a core operations environment composed mainly of in-house developed systems.
- Enhancing the customer experience is emerging as the most important goal of core operations modernization projects.
- An "integrated channel" model directly coupling digital channels and core processing functionality within a single platform is seen by 42% of carriers as the optimal architecture to support their growth strategy.
- However, 46% of carriers need at least a further two years to implement this model.
- This places much of the industry at a competitive disadvantage and exposed to disruption by new entrants for the mid-term future.
- Insurers in emerging markets are aggressively implementing SaaS and cloud technology to bring about rapid transformation of their core operations. In emerging markets, 23% of carriers plan to use cloud to support the majority of core processing within 24 months, nearly twice the proportion in North America and Europe.

## Market context

### The insurance industry is poised for major change and threatened by new entrants

Major shifts in demographics, economic power, regulation, and technology over the next few years will bring about the most fundamental restructuring of the global insurance industry in its long history. In the mature markets of North America and Europe, the continuing sluggishness of many economies and high levels of market penetration and commoditization mean that many insurance sectors will see only weak overall growth, and increasingly intense competition. However, demographic shifts in many markets present opportunities, with an aging population with more wealth to protect and manage driving expansion in the retirement, health, and long-term care insurance sectors.

Among the strongly emerging economies, particularly those of India, China, and Latin America, rapid growth of the middle class means that hundreds of millions of customers will be entering the insurance market for the first time, offering insurers significant growth opportunities over the next decade.

Across all these markets, the attitudes and expectations of the "millennial" generation, which has become an increasingly important segment, are dramatically different from those of their predecessors. Millennials demand convenience, transparency, flexibility, and control when interacting with an insurer, yet the industry has been slow to respond to these expectations. Complex and inconvenient processes built around inflexible and opaque products characterize the experiences of many policyholders when dealing with their insurer. Poor customer experience and a wider lack of trust in financial service organizations have resulted in many carriers struggling to be seen as the obvious first choice for insurance products by the millennial generation.

The industry's generally lackluster response so far presents aggressive new entrants with an ideal opportunity. Against this backdrop, players such as Google, Facebook, and Amazon – with their strong customer focus, good brand recognition, and significant technology and financial resources – as well as innovative start-ups are ideally placed to bring about rapid and widespread disruption within the insurance sector.

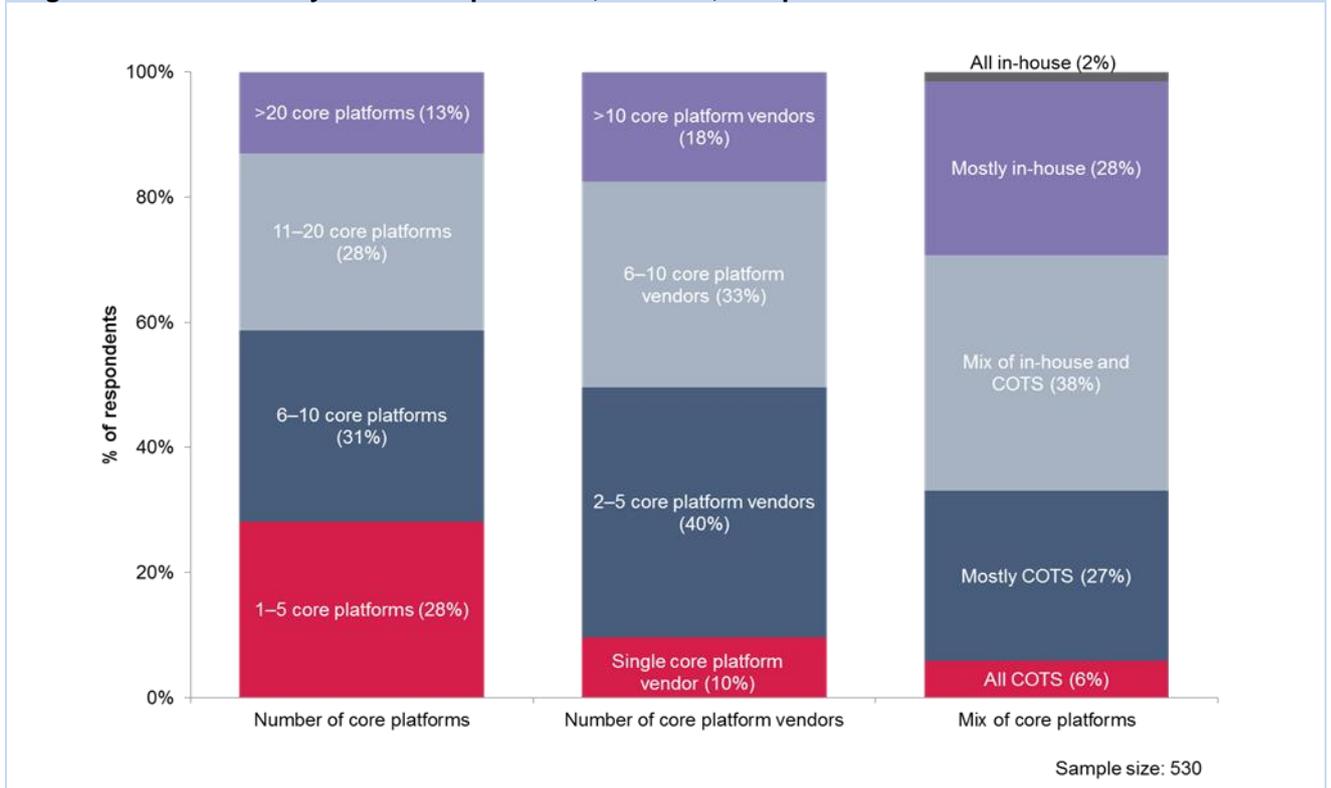
## Many core operations environments remain fragmented, costly, and inflexible

The insurance industry was an early adopter of IT, starting in the 1960s and 70s. The sole task of these early systems was to provide a highly efficient and reliable means of maintaining the details of millions of policies. The lack of commercially available platforms during this period meant that many systems were developed in-house by the insurer's own internal IT group. Although highly effective for managing a growing number of policies and utilizing cutting-edge technology at the time, most of these systems were developed to support specific product lines being sold into a steadily growing and well-understood market. Subsequent industry consolidation, both nationally and globally, meant that many insurers found themselves operating multiple core operations platforms that were unable to interoperate, and which lacked the flexibility to be reconfigured or consolidated.

The issue of "legacy" systems is not new, and many insurers have attempted to re-architect or rationalize their core systems, or have migrated to commercially available insurance packages. Despite the significant effort and investment in these projects, limited IT budgets, the complexity of the task, and a lack of senior management buy-in mean that many insurers still have core operating landscapes that are fragmented, inflexible, complex, and costly to manage.

Ovum's annual ICT Enterprise Insights survey shows that investment in core operations platforms is consistently the single largest area of IT spend for insurers, consuming on average 61% of the IT budget. Despite the industry's protracted efforts, this latest study reveals that the core operations landscape remains a complex mix of platforms for the majority of insurers (see Figure 1).

**Figure 1: Breakdown by number of platforms, vendors, and platform mix**



Source: Ovum

Although the study data revealed some minor differences across regions and sectors, the picture that emerges shows a consistent and universal situation across the insurance industry. The largest cohort of insurers (31%) is operating between six and 10 core platforms, while 13% of insurers have more than 20 core platforms. Unsurprisingly, this complexity becomes more marked among larger insurers operating in established markets, with nearly a quarter of North American insurers operating more than 20 core platforms.

The core operations landscape is further complicated by typically consisting of a mix of both "commercial off-the-shelf" (COTS) packages and in-house developed platforms, with the largest group (38%) of all insurers having an equal mix of both in-house and COTS platforms.

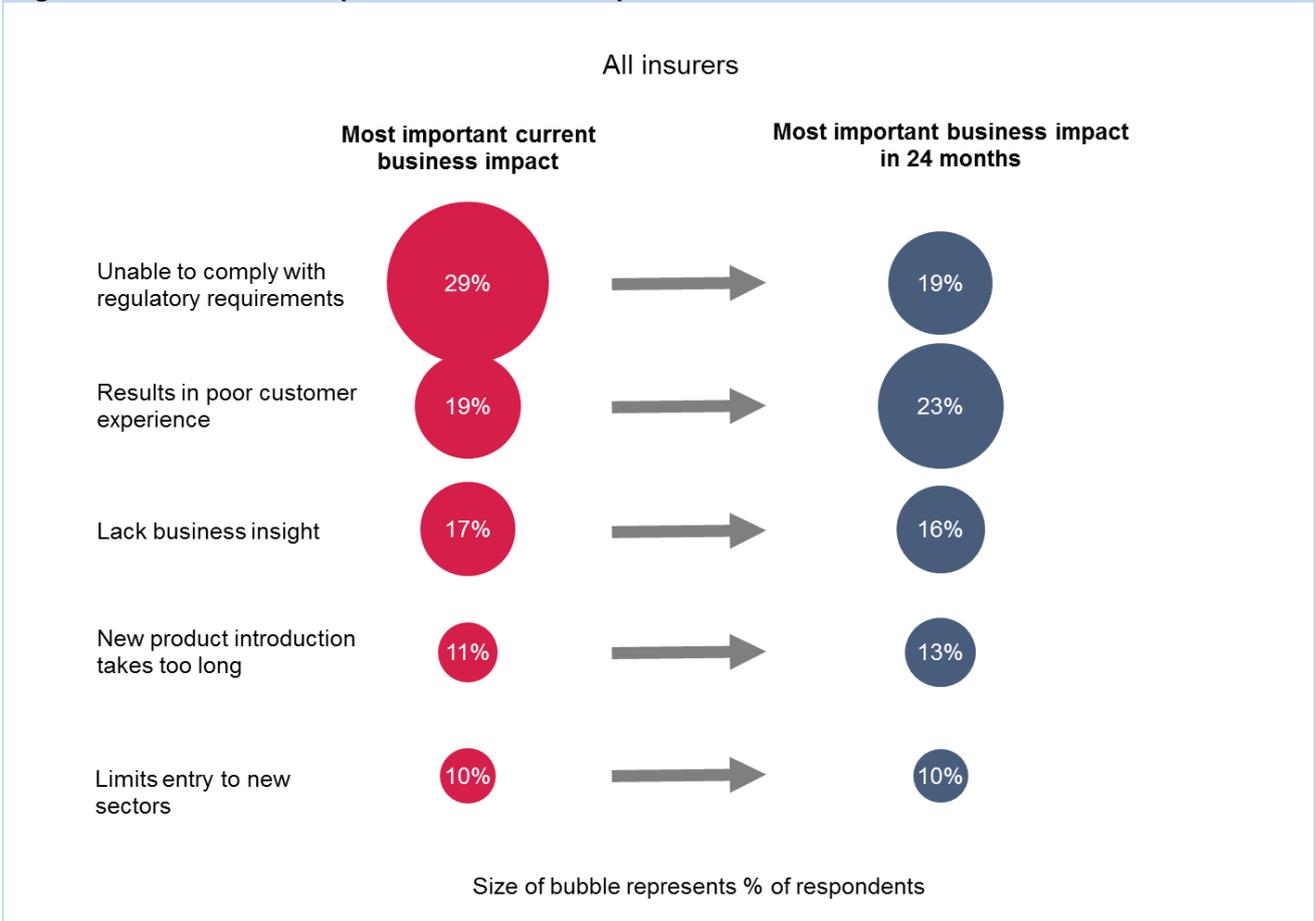
The situation in which many insurers find themselves with regard to their core operations environment is often the culmination of a series of decisions made over a number of years, each of which made pragmatic business sense at the time. However, the fundamental shifts taking place in the insurance industry currently are rapidly exacerbating the negative consequences arising from outdated core operations systems, and are inhibiting the carrier's ability to compete effectively in an increasingly demanding market.

## Market challenges

### Poor customer experience is the primary consequence of current core operations environments

It is important to understand the impact and consequences that current core operating environments have on a carrier's business, and how this affects its ability to compete. Figure 2 shows the five most significant business consequences resulting from the core operations environment currently, and how these will evolve over the next 24 months.

**Figure 2: The business impact of current core operations environments**



Source: Ovum

The fragmented nature and inflexibility of many core operations platforms make it difficult for insurers to ensure products and processes comply with regulatory requirements. The impact of compliance tends to be felt in terms of additional reporting requirements, the need for greater operational control, and strengthened governance and oversight. The first two areas in particular present a significant challenge in many current core processing environments, especially in providing the data required for reporting that is often located across multiple and incompatible platforms. This is the most prominent current business consequence for insurers in Europe, Asia-Pacific, and Central and Latin America. The need to ensure regulatory compliance has been an increasingly significant and mandatory area of IT investment, particularly following the global financial slowdown. However, most insurers now believe that the continuing efforts and investment will fall significantly in the mid-term future as the impact of current projects in this area begins to be felt, although it will remain an important issue.

For many study respondents, existing core operations platforms are inhibiting their ability to deliver a good customer experience, as often seen in the need for customers to repeatedly provide the same information, being limited to conducting certain transactions via a specific channel, or not being updated regarding a claim status, for example.

Given the commoditized nature of many personal line products and growing competition in key markets, the impact of a poor customer experience will become increasingly critical, and is set to emerge as the most important consequence among the majority of insurers within 24 months.

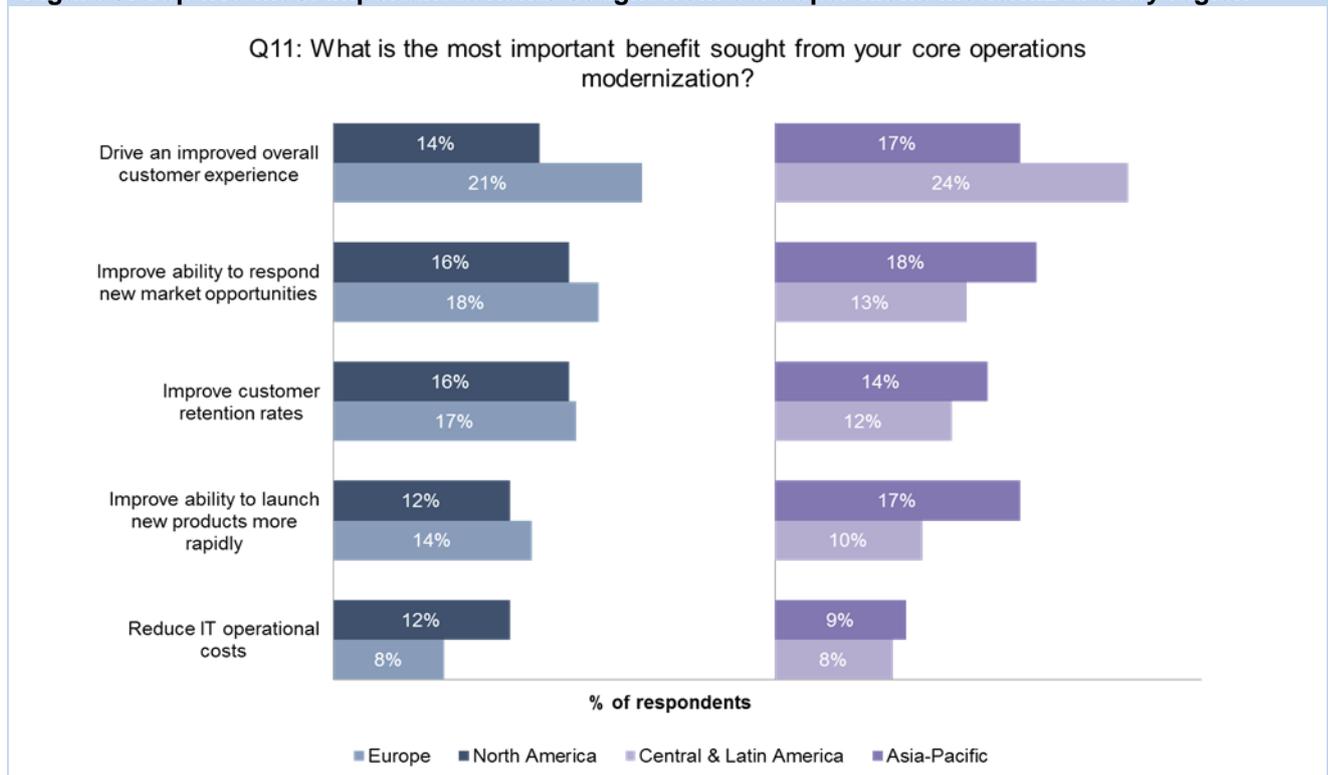
Although having the ability to extract meaningful insight appears to have declined in importance slightly, the aggregate view masks considerable regional differences. Among North American insurers, this issue will grow considerably, from 10% of respondents in the region considering it the most significant current business limitation, to 18% in 24 months' time, making it the most important consequence.

Somewhat counterintuitively, lack of business insight has fallen sharply as a future consequence among European insurers, falling from 21% currently to 12%. This initially surprising outcome has been driven by the major investment all European insurers have had to make to ensure compliance with the Solvency II directive. Many European insurers have implemented systems that serve a role beyond just meeting the compliance needs of Solvency II. As a consequence, these systems are bringing together previously disparate and isolated data from core operations platforms, and allowing sophisticated analysis and modeling to be performed.

## Enhancing the customer experience is the primary goal of core operations modernization

Figure 3 shows the top five benefits sought from current core modernization projects, broken down by region.

**Figure 3: Top five most important benefits sought from core operations modernization by region**



Source: Ovum

Among European and Central and Latin American insurers, improving the customer experience emerges as a clear primary objective for core operations modernization. The continuing weakness of many European markets and intense pricing pressure, driven in part by the pivotal role of price comparison websites in some key European markets, are driving insurers toward a strategy of acquiring and retaining policyholders through an enhanced customer experience. Central and Latin American insurers are responding similarly to some recent slowing in the Brazilian and Mexican economies, and to growing levels of competition in the region.

Among Asia-Pacific insurers, the ability to launch new products and respond to market opportunities emerge as primary goals. These are key operational requirements as insurers attempt to secure business in the rapidly growing and dynamic emerging markets in the region. In addition, delivering a good customer experience ranks equally highly, suggesting that insurers in the region do not see these opportunities as simply a "land grab," but are also attempting to build and retain customer relationships for the future.

The study revealed a more balanced set of core modernization objectives among North American insurers, with a relatively narrow range of scores across all five goals. This suggests insurers are having to use a broad combination of more nuanced strategies to meet the generally higher customer expectations of the North American market.

Although the need to reduce IT operational costs remains a significant driver, in particular among North American carriers, its relative importance across all respondents has fallen in the last three years as carriers move away from pure cost cutting toward cautious strategic reinvestment in IT.

When the study data is examined in terms of size of carrier, the responses from insurers with annual premiums greater than \$1bn were consistent in citing customer experience and responding to market opportunities as the primary goals. However, for the smaller carriers, reducing time to market was the most significant goal of core modernization initiatives. Although this group might have less complex core operations environments compared to tier-1 and tier-2 players, the IT resources required to implement new products still present a very significant issue limiting their ability to challenge their larger competitors.

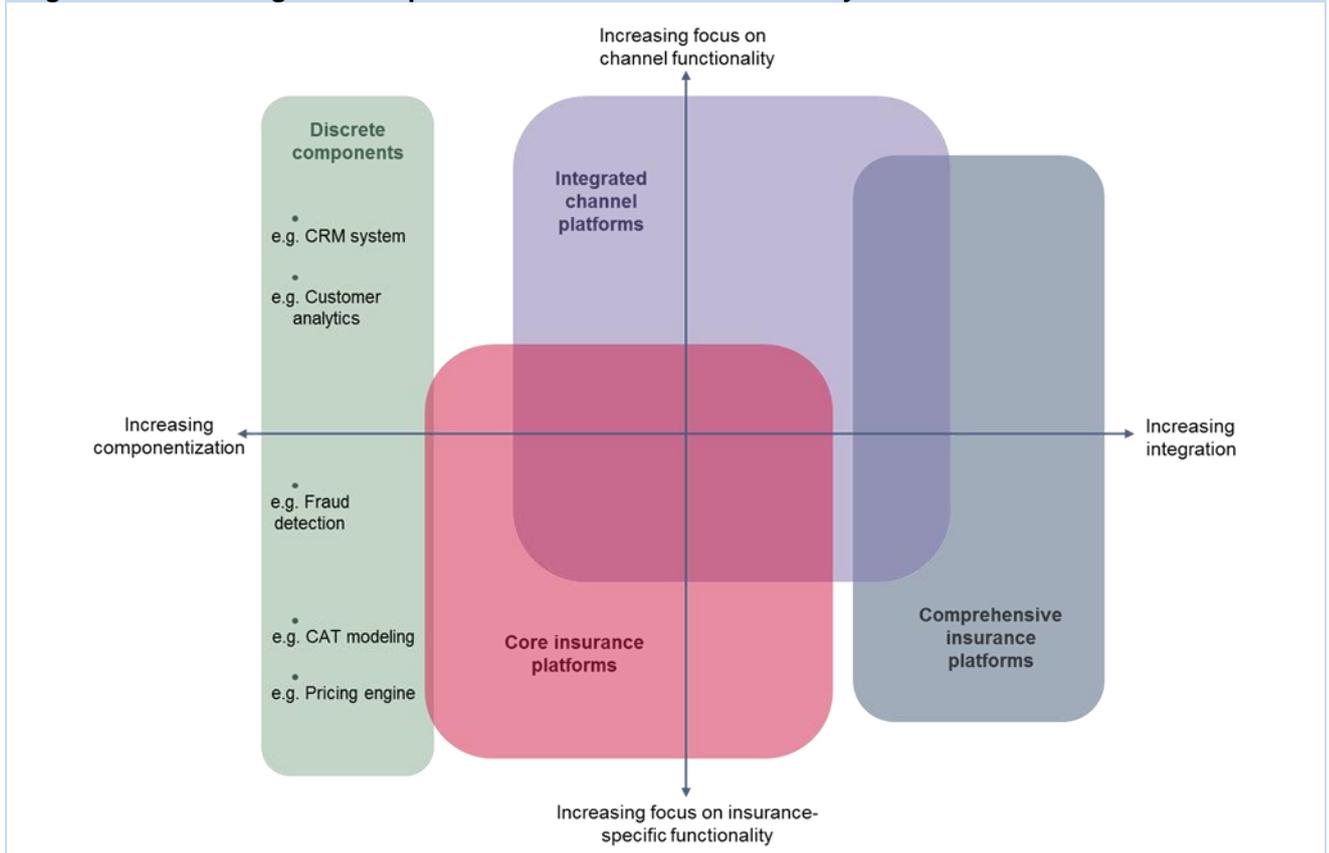
## Integrated channel functionality is a key goal of current modernization projects

To understand the modernization strategies being implemented by respondents, Ovum defined four core operations models. These models were characterized by the degree of integration between functional components, varying from a platform comprised entirely of discrete componentized software modules (the so-called "best of breed" approach), through to a fully integrated model where the majority of the core operations functional needs are encompassed within a single platform, termed a "comprehensive insurance platform."

The models are also characterized by the degree of focus on providing insurance-specific functionality such as an underwriting workbench, pricing and rating engines, and insurance product configurators. Models that emphasize strong insurance-specific processing capability are termed "core insurance platforms." Platform models that place more focus on strong integration of channel functionality with core processing to provide direct and automated communication and interaction with policyholders, intermediaries, and loss adjuster and other carrier partners across a mix of digital channels (including mobile, social, text, and web chat) were termed "integrated channel platforms."

Although the categories are not precise and there is some degree of overlap, the positioning of the various models against the two dimensions is illustrated in Figure 4.

**Figure 4: Positioning of core operations models used in the study**

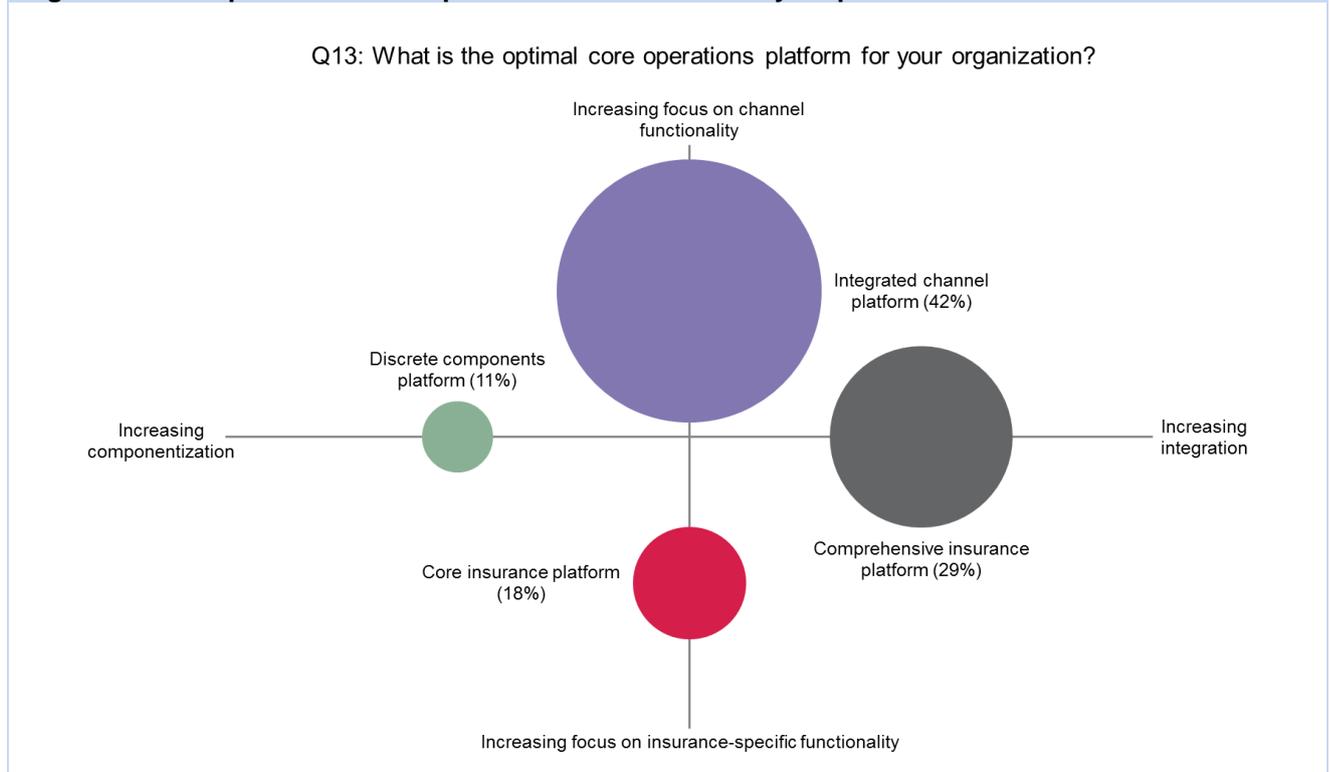


Source: Ovum

Study respondents were asked which core operating model was the most appropriate to support their organizations' strategic goals, with the results across all respondents shown in Figure 5. The results show that a significant majority of insurers are attempting to implement a core processing architecture that integrates communication channels and core processing functionality within a single platform. There was only minor variation from the view shown in Figure 5 across European, Asia-Pacific, and Central and Latin American respondents. The results from North American insurers revealed a more varied view, with the "integrated channel platform" and "core insurance platform" models scoring 36% and 34% respectively, and the "comprehensive insurance platform" model scoring 22%.

The choice of model at regional level aligns well and supports the differing key benefits being sought from core operations modernization. For insurers in European and Central and Latin American markets in particular, as well as Asia-Pacific, an "integrated channel platform" model that emphasizes strong channel functionality will support the strategic goal of enhancing the customer experience. The broader mix of market strategies being used in North America reflects the less polarized choice of core operations models. Greater emphasis on capabilities such as rapid product introduction and agility to respond to market opportunities is better supported by a "core operations platform" model, with a greater focus on aspects such as strong product configuration capability.

**Figure 5: Core operations model preference across all study respondents**



Source: Ovum

The "comprehensive insurance platform" model scored moderately well, and although this underlines the overall trend toward more integrated platforms, it does suggest that carriers lack confidence in the maturity of current offerings of this type, and the ability to offer a consistent level of functionality across all aspects of core operations processing.

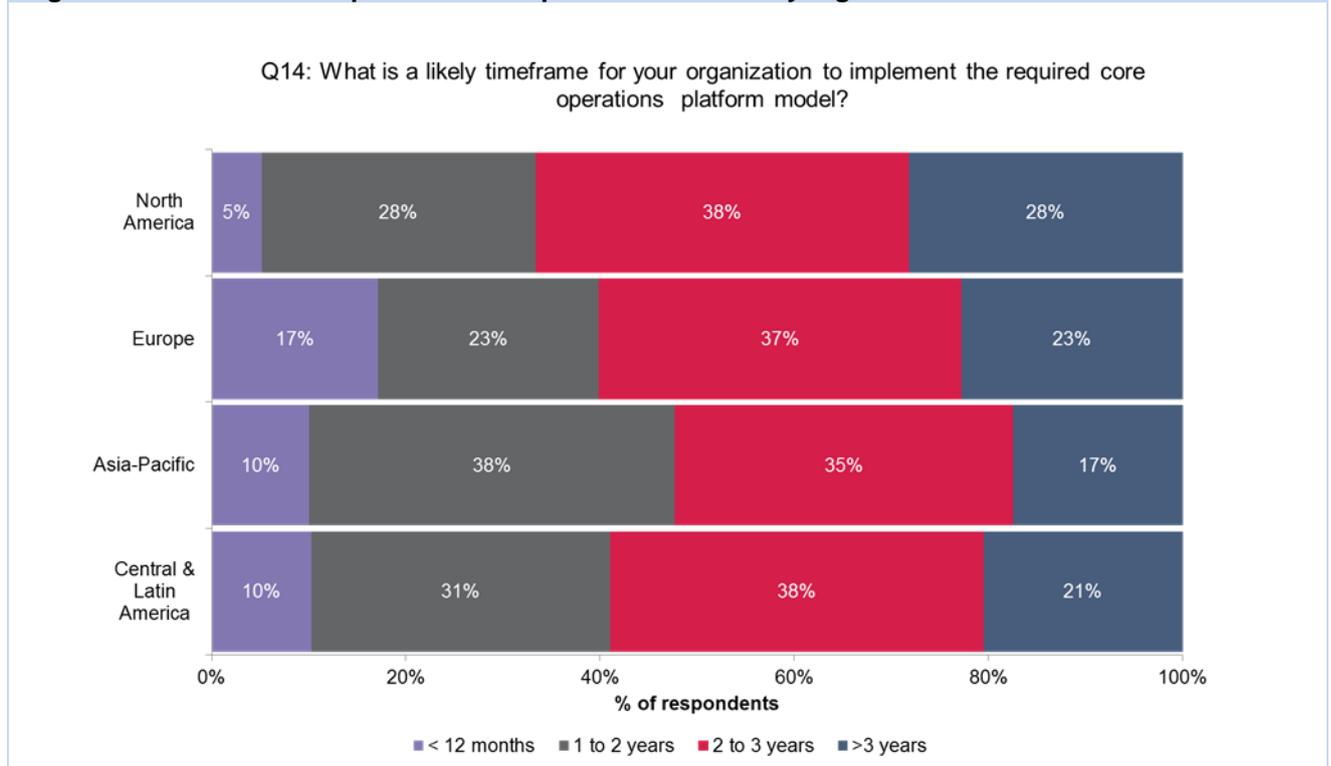
The fully componentized best-of-breed model emerged as the least popular choice by a significant margin across all regions, and even among larger tier-1 carriers, where this architecture has had some traction in the past. Ovum believes that as the capabilities of more integrated platforms continue to evolve, the benefits offered by the specialist functionality of discrete software components set against the added system complexity and management overhead is becoming increasingly marginal. As a result, the best-of-breed model is becoming less attractive.

## Market outlook

### The majority of carriers will be at a competitive disadvantage for the next three years

Respondents were asked about the timeframe for implementing the core operations platform model most appropriate for their organization, with the results by region shown in Figure 6. For the largest cohort across each region, delivery of a suitable core operations model was considered to be between two and three years away. In Ovum's view, this leaves the majority of insurers at a significant competitive disadvantage, and exposed to the threat from either carriers that are further advanced in their core operations transformation, start-ups, or new entrants from outside the insurance industry.

**Figure 6: Timeframe to implement core operations models by region**



Source Ovum

European carriers are currently the most active in implementing core operations modernization projects, with 17% of respondents in the region delivering these within the next 12 months. To a large extent, this is a consequence of Solvency II driving the need for significant modernization of many core operations environments to meet compliance needs. This is borne out by European insurers showing the lowest proportion of modernization projects completing in the one- to two-year timeframe, just beyond Solvency II coming into effect in January 2016.

## Insurers need to accelerate core operations modernization efforts

The insurance industry is acutely aware of its very significant exposure to major business and technology disruption over the next few years. Although there has been a tendency for the industry to adopt a "wait and see" stance, the threat posed by strong new entrants and agile start-ups is instilling a sense of urgency, with most insurers now at least planning to make their core operations environments "fit for purpose."

The study reveals that the integrated channel platform model supports many insurers' objectives of acquiring new business and retaining existing customers by offering an enhanced level of customer experience. However, insurers must accelerate core operations transformation efforts if they are to reduce the risk of being left at a competitive disadvantage for the next two or more years.

Software-as-a-service (SaaS) based core operations platforms running on cloud infrastructure provide a means to move quickly to an integrated channel platform while minimizing initial capital investment. Insurers have been strong adopters of SaaS and cloud technology across the wider organization, but the study shows that only 6% of respondents overall are currently using the technology specifically in support of core operations. However, insurers in the emerging markets are being far more aggressive in the introduction of cloud in support of core operations, with 24% and 19% of respondents in Central and Latin America and

Asia-Pacific respectively moving toward the majority of core processing being performed on cloud within the next 24 months. This compares with only 10% of North American and 12% of European respondents.

Ovum believes that insurers, if they have not done so already, urgently need to include SaaS and cloud technology as key elements of any core operations modernization plans. This should particularly be the case for carriers in mature markets, despite the challenges this will present. At the very least, insurers need to be implementing SaaS-based core operations "proof of concept" projects now to deliver organizational benefits in the near-term, and to develop the technology skills and experience to address potential issues such as regulatory compliance.

## Appendix

### Methodology

#### Study demographics

For this study, Ovum interviewed 530 senior IT decision-makers from the global insurance sector during July and August 2015. The survey respondents were typically Chief Information Officers (CIOs), Heads of IT Strategy, or Heads of IT Architecture, and had a leading role in deciding their organizations' IT strategy, with control of IT budget and an understanding of their current IT systems landscapes.

All respondents' organizations were insurance carriers from both the life and non-life (general/property and casualty) insurance sectors, operating across a number of geographic regions and of varying size in terms of annual premiums. Health insurers, reinsurers, and insurance intermediaries, such as brokers, were not included in the study. The breakdown of respondent organizations by sector, region, and size is shown in Table 1.

**Table 1: Respondent breakdown**

<b>Sector</b>	<b>Number of respondents</b>	<b>% of respondents</b>
Life insurance	265	50%
Non-life insurance	265	50%
<b>Region</b>	<b>Number of respondents</b>	<b>% of respondents</b>
North America	50	9%
Europe	200	38%
Asia-Pacific	180	34%
Central and Latin America	100	19%
<b>Annual premiums (\$m)</b>	<b>Number of respondents</b>	<b>% of respondents</b>
Less than \$5bn	122	23%
\$5bn to \$20bn	297	56%
More than \$20bn	111	21%

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## Ovum Consulting

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