SAPIENS Partnering for Success

Old Co New Co

White Paper

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1. A Problem Waiting to Happen

One of the realities of the Life and Pensions industry is that the time spans of organisational strategies do not always align with the time spans of the products produced to support those strategies. The average tenure of a FTSE 350 CEO is around six years, yet many insurance products are designed to last 30 plus years. The clear conclusion to be drawn from this is that the key drivers of strategy within an insurance organisation have often moved on before the products designed to support those strategies come to maturity.

The Life and Pensions industry, as we all know, is essentially a long tail business. Insurers are in the business of protecting and investing for a lifetime. And yet, as we have all witnessed, changes in economic means, legislative requirements, fashions, and consumer behaviours and needs, means that yesterday's product is not always fit for today's consumer. In the 1980s, with profit endowments were the product du jour and most insurers wanted a product of that ilk in their armoury. Yet the mortgage review and subsequent market reaction meant that it was difficult to sell a with profit endowment by the year 2000. And yet those products are on the books today, and they still need to be supported until their maturity dates sometime in the 2020s.

This is an inevitable outcome of the simple fact that individual lifestyles evolve over generations, and therefore the insurance products that fit those generations must also evolve. But this does put the insurer in the difficult position of essentially selling one set of products, whilst supporting several, potentially very different sets of older products. It puts the insurance world in a fundamentally different place from the high street retailer who can simply clear old stock at the end of a season and start afresh come spring. The insurer's spring never comes.

In this paper, we will look at the implications of this tension between the forces that drive an insurer's engagement with today's world and their need to support yesterday's products. We will look at the different forces that shape a new business strategy and the obligations that remain for the existing books of business, and how they impact each other. We will also show how these forces inevitably lead towards a logical separation of the new business that an insurer is selling (New Co) and the old books that they continue to support (Old Co). And finally, we will show how an organisation can use new systems together with best of breed processes and how its own people can benefit from such a logical separation.

2. The Sales Imperative and the Open Book

2.1 Today's New Business Needs

To remain competitive in today's new business market, be it pensions, investment or protection, there is need to sell all organisations need to make sales to sustain the business model, and these sales, in the simplest form, need a receptive audience and an attractive product. This very basic sales imperative is the key driver of the new business needs of an insurer. And yet ensuring that you have the right product reaching the right audience is not that simple. In today's world, that could mean:

- Adoption of new digital technologies
- The product design lifecycle must be shortened - products must be brought to market quickly before tastes, legislation or economic needs move on
- Supporting new distribution channels
- New business and in force policy servicing requirements demand differing degrees of self service support
- The right brand experience
- Guaranteed quotes, underwriting at source
- One stop shop service – all your insurance needs with one provider
- Competitive pricing

2.2 Supporting Today's New Business Needs

It's difficult to put exact figures against the development of new products with so much variability between markets and insurers, but it is clear that increased regulation, reduced margins and the requirement for a larger technology footprint (with the advent of digital demands by customers), are all driving up the cost of bringing new products to market.

This means that within an organisation, the new business and in force servicing machines need to be slicker: it must be more focused on what it is delivering, it must be able to adapt to the changing market and it must be cost effective. To enable this, an organisation must be set up in the most efficient way. For new business, this means:

- Systems flexibility such that 'change' can be readily configured without the need of expensive IT resources and schedules.

- Processes that must be production line efficient – they must be repeatable and consistent, enabling the insurer to keep operational costs down, but must also be able to deliver an ever more engaging and compliant customer experience.
- 'One and Done' –processes that have minimal user touch-points
- New enabling technologies, each of which need to be integrated with the administration platform quickly.
- Each distribution channel has subtly differing process requirements that need to be simply configured while maintaining processing consistency across the landscape to deliver operational efficiencies.
- Visibility and understanding of business intelligence around existing client information – using the assets the company already has access to
- And perhaps most important, the access to the capital and resource availability needed to ensure all of the above can happen

3. Legacy Business Obligations

With the exception of the greenfield company, all insurers have the obligation of administering books of business that were sold decades ago. Perhaps in the past the industry has given a little less focus to these clients than is their due, but with the increased oversight of a more regulated industry and the requirement to treat all customers fairly, there is now a larger burden on insurers to ensure that their older customers are not ignored.

This brings a new set of challenges that are not really relevant to the new business world we have discussed earlier:

- Products that are operating under different legislative regimes to those that are currently being sold
- Knowledge of the legacy product set ordinarily resides with those who were around when the products were originally being sold. For the oldest products this raises the spectre of knowledge drain – the people who know the products are retiring and taking the required knowledge with them.
- Older systems are seldom sophisticated enough to have the 'product knowledge' embedded within them
- A large financial burden is incurred in reserving funds to support the projected operational overheads (operational, IT etc.) for the lifetime of the products
- The proliferation of processes that arise as a result of changing strategies, different management perspectives and of course, different systems. Processes often develop in sync with the systems that support them, thus the more systems you have, the more processes you have.
- And of course, the fixed cost of maintaining so many systems

3.1 New Business Versus Legacy – New Income Versus Old Investment

Even a cursory glance at the forces impacting new business and legacy strategies can tell that these forces are not necessarily working in the same direction.

The insurer's new business strategy demands an engagement with clients through digital media with minimal interpersonal contact, whereas a legacy book is often populated with older, more change resistant clients who want to hear a friendly voice on the other end of the line. These strategies require different processes, different systems and, most importantly, differing skills to service them.

An organisation should have a single view of their client, encouraging the concept that the insurer is a partner for life, yet with older books this view is compromised by administration by multiple operational departments, using multiple systems, and with very little communication between them.

3.2 Legacy Drag

Then there is 'the legacy drag', the impact that managing a fragmented legacy book has on the new business strategy.

The obvious impact of legacy drag is the inability to instigate process rationalisation. In an ideal organisation there is a single death claim process, a single annual statement template, a single top up process etc., but the fragmentation of books of business (invariably as a result of an ever-growing roster of systems) means this is not possible. Invariably, this means that best practice processes for new business is always contaminated by the need to support the old books.

This has the knock on effect of creating distinct user communities, rather than enabling an organisation to operate with a single user community, agile and able to move where required, when required.

And finally there is the financial impact. In an ideal world, the legacy books are managed/administered as a single, cost efficient unit, leaving the bulk of new investment available for new business initiatives. Unfortunately, for most organisations, this is not the case, and much of that investment is used to support old, non-strategic business. One only has to look at the cost overheads incurred as part of Solvency II and CoBs legislation.

4. Addressing the Problem

4.1 An Urgent Issue

The issue of how to manage Closed Books business without compromising New Business strategy has been around for a decade, and organisations are unlikely to stop accumulating Closed Books in the near future.

We are currently in the midst of a cycle of heavy industry regulatory change, with legislation being imposed both domestically, with the forthcoming annuity white paper and recent RDR changes, and internationally as the EU look to put a footprint on the way financial business is managed in the UK (as the latest IMD2 legislation proves).

Technology is accelerating the speed at which new products and new approaches to selling those products are required; today's digital world is fundamentally different to the world of yesterday.

Economically, as the UK emerges from recession, consumers will start to look for opportunities to invest their money, many of which will be provided by new insurance/ investment products.

All of this means that another cycle of product development is beginning, with today's products becoming tomorrow's closed books.

One of leading analyst organisations, Celent, believes that many insurers will begin considering alternative accelerated solutions involving either the sale or transformation of the business that supports the closed books. Furthermore, there are a growing number of proven technology propositions that can be employed as part of a transformation without the need to sell or outsource the problem.

"With a growing market of mature and proven capabilities consisting of options to both variabilise costs and contain liabilities, insurers can no longer say that there is an absence of viable alternative strategies," says Jamie Macgregor, Senior Analyst with Celent's EMEA Insurance Group.

Legacy policy administration systems are costly to support and not best suited to deliver the changes required of today's market. The costs associated with IT maintenance and support personnel for multiple systems are high and the business resources required to support the patchwork of systems often result in duplication of effort. A larger and sometimes difficult to quantify cost lies in the area of system integration. The rollout of any new service, automation project or software package involving policy administration is greatly impacted by the costs associated with interfacing them to the multiple support systems.

Each legacy system is unique, each with differing processes and operational structures making efficiencies and consistency of operational processing impossible resulting in a disproportionately high in force cost per policy, increasing as the legacy portfolios run off.

4.2 What Has Been Tried So Far

There have been many takes on how to manage what is perceived as 'the Closed Books problem'.

'New Businessing' out of trouble has been the traditional approach for many organisations. This is the idea that an organisation can simply continually build new business capabilities that are relevant to the current market needs, whilst allowing their Closed Books to stockpile. This strategy is fraught with risk (and seldom achieved), as the Closed Books and the attendant legacy systems simply accumulate until they become unmanageable..

An alternative is to sell the book. This certainly removes the legacy obligation, and immediately allows the retiring of the systems that support those books thus reducing the fixed cost overheads. But often selling the book doesn't take into account the true value of the business – in addition to the loss of financial assets (and the attendant financial strength they provide), this approach also sacrifices a potentially lucrative captive client database.

In the latest decade, Business Process Outsourcing (BPO) has been the de facto choice for managing Closed Books, and in itself this not a bad solution. BPO enables the insurer to offload the servicing obligations but retain the financial strength of still owning the book of business. However, BPO does not provide a long term solution, since the consolidation exercise is seldom completed, and insurers are often faced with a return of the same infrastructure upon completion of the BPO contract, albeit a smaller book due to run-off.

The real reason that these approaches have either failed, or at best been a qualified success, is an underlying assumption that 'Closed Books are a problem'. The conflict between New Business strategy and Closed Books obligations is indeed a challenge but we believe an Old Co/New Co approach enables an insurer to treat them as equal but different aspects of the organisation.

5. Old Co – New Co

> **"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change"**
>
> **- Charles Darwin**

So how does an organisation align the issues arising from the conflict between the new business requirements and the legacy obligations?

We believe the answer lies in a discrete division of the business, the Old Co versus New Co strategy. A business unit is created to administer all new business, distinct from a second business unit, created to administer all of the legacy business.

This enables a 'divide and focus' approach to be put into practice. The organisation can divide those parts of its business that are fundamentally different, enabling a clear focus to be applied to each without contamination from the other.

5.1 How Do I Achieve an Old Co/New Co Split?

Each organisation will approach the Old Co/New Co split differently, but there are a number of key common practices that make sense for all organisations engaging in an Old Co/New Co split.

- Divide and specialise the user communities – two distinct user communities able to focus and utilise distinct skill sets for front and back office functions (e.g. client facing skills will be of more use in a New Co environment, whereas detailed and historic product knowledge can be used in an Old Co environment)
- Create separate decision making hierarchies – ensure that day to day business decisions do not bind Old Co and New Co to the same strategy
- Consolidate the legacy book technology – ensure that the legacy business is all managed from a single technology base
- Consolidate the business process – adopt the principle of 'separate but consistent' processes for Old Co and New Co – separate the processes according to their function as New Business or Day Two functions, but ensure consistency of approach
- Create a single organisation architecture – Old Co and New Co will operate independently, but corporate synergies should not be dismissed, e.g. single view of client, a unified financial reporting approach etc.

5.2 The Benefits of Old Co/New Co

The benefits that can be obtained from an Old Co/New Co 'divide and focus' approach are transformative for an organisation looking to attain greater agility:

- Process Rationalisation – with all the books of business managed on two systems by two communities, it is much easier to rationalise the many processes that an organisation ordinarily supports.

- Specialisation – it is easier to put the right knowledge in the right departments – there are no more square pegs in round holes
- A Heritage director and a New Business director – one can make pragmatic, cost based decisions for the legacy book whereas the other can focus on increasing sales without considering the legacy drag effect..
- Two communities not 99 – Resources become more mobile, enabling a more efficient usage of individuals (there are no more section 32 buyout specialists waiting for the once a month enquiry for that small client base)
- Single support infrastructure – It is a lot easier to attain a single view of finance, actuarial etc with two communities as opposed to ninety nine

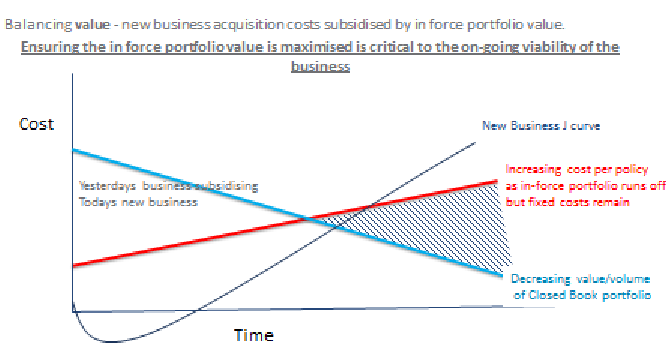
These can, if managed appropriately, give rise to:

- Reduced IT costs
- Reduced Operational costs – reduction in overall headcount
- Increased one and done processing
- Improved financial control and audit
- Enhanced and consistent customer experience and service
- • Realisation of embedded values resulting from a lower 'fixed cost' per in force policy

5.3 One More Financial Impact of an Old Co/New Co Split

One more financial impact of the Old Co/New Co split is the impact that it has on the operational reserving position of an organisation. Due to the long term nature of Life and pensions business, these organisations are required to set aside financial reserves to ensure that they are able to meet the operational overheads of administering those books of business for the duration of their terms.

A typical reserving position for a life and pensions organisation is illustrated below:

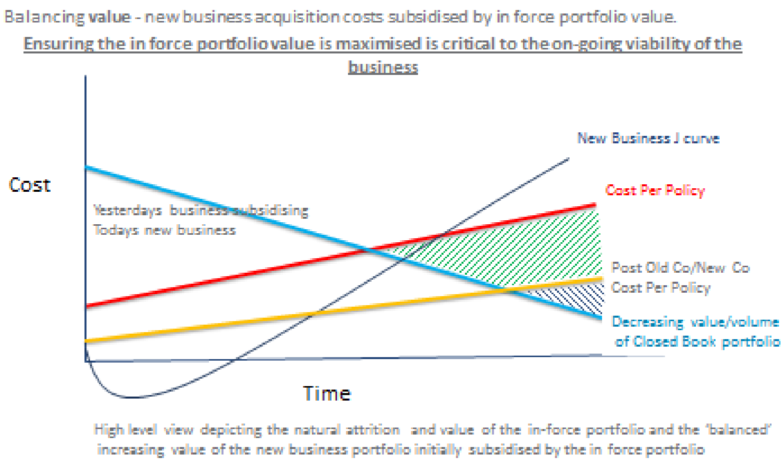


High level view depicting the natural attrition and value of the in-force portfolio and the 'balanced' increasing value of the new business portfolio initially subsidised by the in force portfolio

The shaded grey area is the operational reserve that the insurer must set aside to support the administration of those products going forward. As can be seen from the diagram, the two key impacts on the amount that must be reserved are the value of the book of business and the cost per policy of that book.

One of the major benefits of an Old Co/New Co split is the driving down of the price per policy – many of the benefits described above (such as single processes, reduced IT overhead etc) remove administration cost.

And whilst this cost reduction in itself is a major reason to pursue an Old Co/New Co approach, the additional benefit is that an organisation can release reserved funds as its cost per policy is reduced. This is shown below:



The yellow line represents a reduced cost per policy post Old Co/New Co split. This reduction in price per policy opens up the release of the green shaded area. When set against the high volumes of legacy book business, this amount can be worth tens of millions of pounds to an organisation.

Why not use this released capital to fund the implementation of the Old Co/New Co strategy. There is potential to make the technology restructure and book consolidation almost a cost free exercise. Alternatively, the capital could be used to fund the New Co business strategy.

5.4 Old Co/New Co Technology

The biggest challenge to all of this, the one for which our industry has a history of failure, is that of the legacy platform consolidation. How do you successfully move multiple existing systems onto a new system, without compromising the agility and new world focus of your new business technology?

The key, we believe, is to ensure that the technologies used to support an Old Co/ New Co split must be purpose built and focused on the part of the split they are supporting.

To support an organisation's New Business strategy the supporting system needs to be:-

- Technologically advanced to take advantage of the latest mobile capabilities in the market place.

- Functionally rich and support high levels of automation.
- Highly configurable and flexible to support the rapid development of new products and changes to product features and business processes without the need for making major system changes.

To support the Closed Books strategy the supporting system needs to:-

- Have a proven ability to support the range of product portfolios.
- Be functionally rich to cater for the plethora of historical product features and business processes.
- Be focused on “Day 2” processing requirements to reduce the cost of ongoing business processing.
- Be able to make the process of migration of data into the system as efficient and painless as possible. The acceptance and processing of “dirty data” from legacy systems is key to achieving this.

Having the ability to migrate to a purpose built and proven Closed Book solution which manages dirty migrated data and which delivers compliant and consistent processing outcomes really does realise significant savings. Significant IT savings will result from legacy systems de-commissioning and significant operational savings will be realised through the adoption of process consistencies and increased automation, all enabled by the use of a purpose built Closed Books system. And perhaps, most significantly, a system that is purpose built to support data migration will enable a cost effective consolidation programme to be exercised without extensive data cleansing and duplication of data transformation.

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