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Responding to the pressures of a volatile insurance marketplace: The advantage of advanced software solutions

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Among the many obstacles facing insurance companies today, market volatility and declining interest rates now rank among the most challenging. Market fluctuations can reduce profits or generate losses because of lower investment incomes, and can lead to a shrinking surplus because of reductions in investment portfolios. Falling interest rates can threaten the very fundamentals of insurance products.

In the face of such pressures, insurance decision-makers are increasingly looking at how their portfolio of products can be designed with agility and responsiveness in mind. How can they make quick adjustments to existing products, tweaking just a few levers or attributes in a matter of days or weeks, rather than having to make more fundamental changes that could take months? How can they cut testing time as much as possible and introduce design flexibility into the portfolio from the very beginning?

Advanced software solutions can give insurers an important edge, helping them build flexibility into their products and speeding time to market through faster, more comprehensive testing.

The challenges of volatility and yields

Insurance executives are painfully aware of the problems of market volatility and low interest rates and their impact on the business. According to the 2012 GSAM Insurance Asset Management Insurance CIO Survey,[1] more than half of chief investment officers and senior investment decision-makers at insurers around the globe expect equity market volatility to increase.

Executives had similar expectations for credit market volatility, with 54 percent of respondents expecting an increase in volatility and 38 percent expecting change to continue, though at about the same level.

Even more threatening to the executives surveyed, however, were falling interest rates. About two-thirds (65 percent) reported that low yields were the biggest investment risk to their portfolios because low yields reduce their companies' earnings. Almost half of the respondents (48 percent) said that investment opportunities are "getting worse" compared to the same time last year.

How, exactly, do volatility and low yields affect product development—or, more accurately, product refreshes?

Companies offering variable annuities or variable life products need to be able to make quick adjustments in response to market change so that their products are either more conservative or more liberal, or more or less profitable, based on what return they can get in the market.

Insurers that primarily sell more fixed or traditional products also need to make rapid updates. As interest rates have fallen, many such companies are now hitting some of the guaranteed provisions of their products. In response, they need to look at the core mechanics of a product and change its underlying guarantees. The challenge goes beyond merely re-pricing a few products; it's about needing to re-price the entire block of business, looking at fundamentals around guaranteed premiums, cash values and death benefits that were initially determined by the actuaries using both mortality assumptions and interest rate assumptions.

These kinds of pressures have already caused considerable fallout in the marketplace. For example, market volatility and low interest rates caused Canadian insurer Sun Life to exit the variable annuity and individual life insurance markets in the United States. As reported in the Annuity Digest, "Continued equity market volatility has resulted in a variable annuity business that is plagued with uncertainty and higher costs. Insurers such as Sun Life offer guarantees that are linked to the performance of underlying equity portfolios. These guarantees are a liability for the insurance company, and equity market volatility contributes to the cost of these liabilities. When combined with a hyper-competitive product landscape such as the U.S. variable annuity market, the higher cost-basis results in what many market participants consider an unattractive market."[2]

Coping with volatility: The software advantage

To a great extent, the ability of insurance companies to respond to these pressures of volatility and low yields is a matter of their underlying software capabilities. Companies must be able to adapt existing products quickly in response to market or regulatory requirements—a capability now equally as important as the rapid development of new, core products.

Companies need to achieve a delicate balance: building core mechanics into products that are likely to stay the same through the life of the product, while simultaneously creating more flexible levers or pricing factors that can be fine-tuned as inputs to the core mechanics based on real-time market and regulatory challenges.

Two software capabilities are especially important:

1. Building flexibility into products

One of the important capabilities of an effective life insurance software solution is a configurable product and business rules engine. Such configurability supports rapid product development but, equally important, enables rapid changes to existing products based on market events. In effect, flexibility is built into products from the start. When a new product is created, it is configured such that pricing factors and rates can be easily adjusted. A designer can perform reconfiguration along with the associated testing, rather than having to rely on a developer to modify the code, which can add weeks or months to the process of making changes.

These more flexible platforms are already in use by several major firms. For example, one North American insurer that offers competitive variable annuity and equity index annuity products has implemented a solution that enables the company to make parameter and lever changes rapidly—within days or weeks rather than the months previously required. Another insurance group that offers traditional life and annuity products that are subject to interest rate guarantees is implementing a solution that enables the company to baseline its products using different guaranteed interest structures.

Whether a product has an unusual characteristic that requires special or unique treatment or whether it just needs a slight adjustment to a particular component, the appropriate software solution can provide a comprehensive platform to create and test the required rules. New features, transactions, rules and riders can all be created to define the instructions for the desired product behavior. The configuration can be as simple or as complex as needed. Advanced configuration is often used in conjunction with templates, allowing a product designer to make use of a standard feature such as a surrender charge, and still create the additional instructions for the adjustment.

2. Ensuring rapid and comprehensive testing

Testing is a capability that can make or break not only new product development, but also the kinds of quick adjustments insurers need to cope with volatility and regulatory challenges. In addition to being able to change attributes of a product in a matter of days, it's also important to be able to test the product with similar speed. If testing takes months, the rapid response benefits can be lost.

This testing capability should be another important feature within a life insurer's software arsenal. A flexible and efficient testing environment can improve the ability of the product designer to analyze, modify and confirm the behavior of new products and features.

Product designers should be able to create test cases, including policy activity such as financial transactions and scheduled events; execute test cases; view ledger results and detailed values; and debug actual transactions and sub-processes. Accenture estimates that these testing tools can reduce product testing efforts by up to 50 percent.

This testing environment also enables insurers to more effectively and rapidly evaluate alternatives to see which is more profitable. The "correct" or optimal response to volatility and low rates is not always known in advance, and companies may wish to test several options to see which delivers a better return. Insurers typically have a heterogeneous system environment so, with a testing workbench, they can try out two or three adjustments and model the different results.

Conclusion: Creating a software advantage

A scan of today's financial headlines highlights the risks insurers increasingly face: reduced profits, lower investment returns, asset depreciation caused by market volatility, and more. In such an environment, an insurer's underlying software platform can provide a competitive edge.

Insurance companies need to increase their overall agility and responsiveness. They need to be able to react to the kinds of market events that can lead to losses from decreased investment income or a shrinking surplus due to a reduction in investment portfolios.

Firms that are unable to rapidly fine-tune the core mechanics of their products as a result of slow IT processes should be considering next-generation software solutions. These platforms can help build flexibility into the products themselves so that pricing factors and rates can be adjusted quickly. Advanced software can also support rapid testing that helps firms modify products and features to react to economic and competitive events.

These IT capabilities create a rapid-response IT environment that can add up to a significant software advantage.

References

1. "GSAM Global Survey: More than Half of Insurers Say Equity Market Volatility Will Rise," Warren S Hersch, LifeHealthPro, July 24, 2012. http://www.lifehealthpro.com/2012/07/24/gsam-global-survey-more-than-half-of-insurers-say

2. "Sun Life yet another Casualty of Equity Market Volatility," Annuity Digest, http://www.annuitydigest.com/news/sun-life-yet-another-casualty-equity-market-volatility

Why Accenture Life Insurance Platform?

The Accenture Life Insurance Platform supports a wide range of life and annuity products for individuals and groups. Used in over 40 implementations globally, the Accenture Life Insurance Platform is a mature and configurable solution providing support of critical business functions throughout the policy lifecycle.

The Accenture Life Insurance Platform is a flexible solution that can be implemented as a complete suite using the pre-integrated systems or as standalone elements.

The Accenture Life Insurance Platform was rated "Positive" in Gartner's latest "MarketScope for North American Life Insurance Policy Administration Vendors", published June 21, 2012.

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