

The Actuarial Profession

making financial sense of the future

The good, the bad and the outsourced

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9th November, 2004

- Background
- Drivers
- Reasons Given
- Risks
- Regulation/Guidance

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Background

- The Good
 - Good service / low expenses
 - Simple products, no legacy systems
- The Bad
 - Poor Service / high expenses
 - Legacy products, legacy systems, acquisitions
- The Outsourced
 - Want to be good, but
 - don't have capital to invest
 - or scale to make worthwhile
 - or discipline

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Background - Typical Services Outsourced

- Administration
 - claims / uw
 - policy alterations
 - complaints
 - call center
- Back Office
 - IT
 - HR
 - finance
 - actuarial
 - investments
- All in

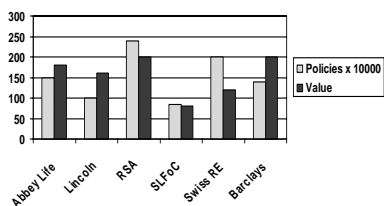
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Background - Growing Market

2001 Abbey Life, Scottish Life
 2002 Lincoln, SLFoC
 2003 RSA, HBOS, St. James Place and
 Prudential International, Zurich IT, Swiss Re
 2004 Liverpool Victoria, Childrens Friendly,
 Winterthur
 2005 ????

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Background - Growing Market



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Background - Growing Market

- Total annual UK life & pensions annual administration costs £3.2bn !
- All UK outsourcing deals to date have about £200m pa revenues
- Over 90% of market untouched.
- International markets bigger still

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Background - Growing Market

UK life and pensions outsourcing market
annual growth forecasts

NelsonHall: 20% to 2008⁽¹⁾
Datamonitor: 15% to 2008⁽²⁾

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Background - Growing Market

Capita
Liberata
Marlborough Stirling
Unisys
CSC
Aquila
Hazell Carr
Huntswood
Higham Group
IBM
Accenture

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Drivers

- Closed funds
 - Want known costs
 - Want variable costs
 - Staff retention
- Open funds
 - Quick access to market
 - Variable cost to market
- All funds
 - Specialist services - focus

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Reasons Given

- Abbey Life
 - improve service
 - staff retention
 - cut unit costs
- RSA
 - variable costs
 - service levels
 - "good news" for employees
- SLFoC
 - certainty - fixed costs moved to variable costs
 - staff - "brings significant benefits to employees"
- Barclays
 - certain costs - securitisation

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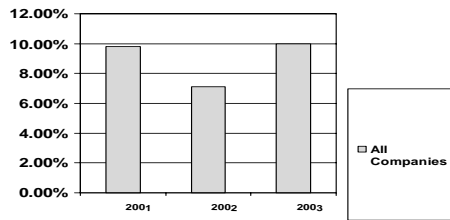
Reasons Given - Costs

- Variable
- Known
- Shared cost developments
- but
 - Ad-hocs
 - Up front unless financing

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Reasons Given - Costs

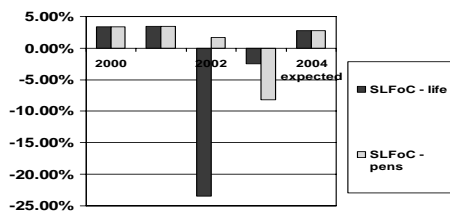
- Increase in per policy costs



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Reasons Given - Costs

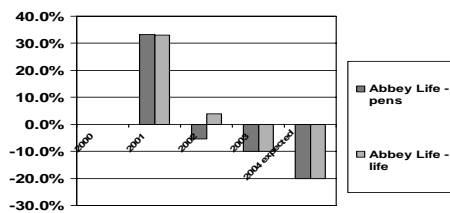
- Costs (changes in Schedule 4 per policy expenses)



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Reasons Given - Costs

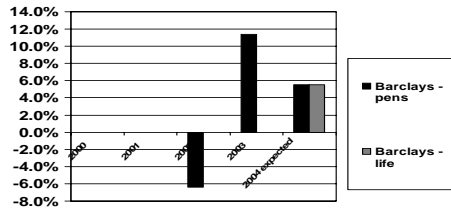
- Costs (changes in Schedule 4 per policy expenses)



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Reasons Given - Costs

- Costs (changes in Schedule 4 per policy expenses)



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Reasons Given - Staff Benefits

- More secure future - growing business not contracting
- Broader opportunities – other areas
- But
 - Low margins, cost management – fewer jobs
 - Different skills -

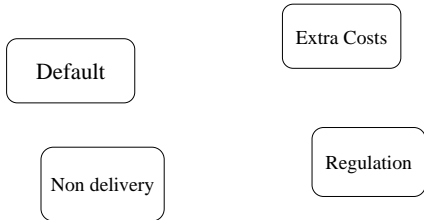
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Reasons Given - Service Levels

- Agreed standards
 - penalties for under performance
 - credits for exceeding standards
- Customers should be unaware of outsourcer

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Risks



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Risks - Default

- Cost of unwinding
- Capital Cost
- Reputation
- Regulator
- Mitigation
 - Exit plans
 - Due Diligence (source : **Orbys**)
 - 28% do not evaluate business case
 - 34% do no risk assessment
 - and some do no due diligence

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Risks - Costs

- Non-SLA projects
- Unwinding or exit
- Governance
- Contract negotiation / re-negotiation
- Capital
- Mitigation
 - clear contract
 - agree basis for changes

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Risks - Regulatory Intervention

- Not meeting PRE
- Non-compliant actions
- Staff levels of training
- Mitigation
 - Clear standards
 - Monitoring
 - Contract

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Risks - Non Delivery

- Service levels fall
- Quality v quantity
- Areas of failure
- Mitigation
 - penalties
 - reward good behaviour
 - contract

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Risks

- Contract
- Maintain good relationship

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Professional Guidance and Regulations

- GN46 - ICAS
- PRU
 - More explicit allowance for
 - policy run off > expense reductions
 - default
 - reversion to "cost plus" at end of contract
 - allowance for "mismanagement of expenses"

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Professional Guidance and Regulations

- PRU 7.3.51 R(2)
- GN44 - Mathematical Reserves and Resilience Capital Requirement
 - "implicit or explicit provision for future increases"
 - does this cover re-negotiation ?
 - SLA 100% variable, governance 100% fixed
 - Load per policy or default reserve ?

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Questions

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