The good, the bad and the outsourced

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9th November, 2004

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

Drivers
- Reasons Given
- Risks
- Regulation/Guidance
Background - Typical Services Outsourced

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

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 ????

Background - Growing Market

- Policies x 10000
- Value
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

Background - Growing Market

UK life and pensions outsourcing market annual growth forecasts

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

Background - Growing Market

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

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

Reasons Given - Costs

- Variable
- Known
- Shared cost developments

- But
  - Ad-hocs
  - Up front unless financing
Reasons Given - Costs

- Increase in per policy costs

[Bar chart showing percentage change in costs over years for All Companies.]

Reasons Given - Costs

- Costs (changes in Schedule 4 per policy expenses)

[Bar chart showing percentage change in costs for SLFoC - life and SLFoC - pens for years 2000, 2002, and 2004.]

Reasons Given - Costs

- Costs (changes in Schedule 4 per policy expenses)

[Bar chart showing percentage change in costs for Abbey Life - pens and Abbey Life - life for years 2000, 2002, and 2004.]
Reasons Given - Costs

- Costs (changes in Schedule 4 per policy expenses)

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenses</th>
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<tbody>
<tr>
<td>2001</td>
<td>-8.0%</td>
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<tr>
<td>2002</td>
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<td>2003</td>
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<tr>
<td>2004</td>
<td>-2.0%</td>
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<tr>
<td>2005</td>
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<td>2006</td>
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<td>2007</td>
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<tr>
<td>2009</td>
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<tr>
<td>2010</td>
<td>10.0%</td>
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<tr>
<td>2011</td>
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</tbody>
</table>

Barclays - plans
Barclays - life

Reasons Given - Staff Benefits

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

Reasons Given - Service Levels

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

Default

Extra Costs

Non delivery

Regulation

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

Risks - Costs

- Non-SLA projects
- Unwinding or exit
- Governance
- Contract negotiation / re-negotiation
- Capital

- Mitigation
  - clear contract
  - agree basis for changes
Risks - Regulatory Intervention

- Not meeting PRE
- Non-compliant actions
- Staff levels of training

Mitigation
- Clear standards
- Monitoring
- Contract

Risks - Non Delivery

- Service levels fall
- Quality vs quantity
- Areas of failure

Mitigation
- Penalties
- Reward good behaviour
- Contract

Risks

- Contract
- Maintain good relationship
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"

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?

Questions