

Finance, Management, & Operations



Build vs. Buy

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Session #4

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14th Annual Intercompany Long Term Care Insurance Conference

- Discuss why and what LTC companies outsource
- Walk through a framework for outsourcing decisions
- Differences between outsourcing and consulting
- Case studies and tools
- Questions and answers

- What are you potentially outsourcing?
 - Full administration of a business
 - Specific process or function within a business
 - IT Systems
 - Consulting

- Why are you looking to outsource?
 - Cost Savings
 - Improved service
 - Process or system not deemed core to business
 - Improved flexibility with staffing and space
 - Required skill set not currently available within your organization

Outsourcing Framework



- Feasibility of outsourcing
- Scoping of areas or activities to be outsourced (core/non-core)
- Build detailed business requirements
- Complete RFP evaluation
- Contracting (Company specific, not going to cover)
- Transition
- Managing outsourced process

Feasibility of Outsourcing



- Corporate Appetite
 - Executive philosophy
 - Existing relationship with outsourcing partners
 - Corporate Vendor Management department
- Existence of viable outsourcing vendors
 - High level review to determine if potential providers exist in the area that is being considered for outsourcing

- How do you define Core / Non-core activities?
 - If starting the business today, would you build this process/system internally?
 - Would other companies hire you to manage this process/system for them?
 - Does this process/system provide world class results at a competitive cost?
 - Does this process/system create or define a unique competitive advantage?
 - Is this process/system directly contributing to business growth or expansion?

Build Detail Requirements



- Defining what the current process is and what future process should be (depending on complexity this can be a significant effort)
- Determining what are the critical success factors are that you want included in Service Levels (typically related to timeliness and quality)

Request for Proposal (RFP)



- Based on size and complexity of the potential outsourcing, the RFP can range in rigor and formality
- Identify potential providers
- Communicating business requirements and what their response should address
- Review and Score responses
- Narrow selection down to finalists and conduct due diligence

- A few key considerations when moving an existing process to an outsourced arrangement
 - Utilization of a project management methodology
 - Timing of transition
 - Impact to policy holders
 - Peak volume time frames
 - Contingency planning

- Considerations for ongoing management
 - Outsourcing doesn't relieve the company's responsibility to the insureds
 - Defining operational metrics and service levels are critical to efficient oversight
 - Auditing requirements

- **Consulting Project**
 - Typically non-repetitive or limited repetitive work performed by a third party
 - Work is usually time limited with defined work product outputs such as written reports
- **Outsourcing/Third Party Administration**
 - Typically repetitive, transaction based processing performed by a third party pursuant to a master contractual agreement
 - Work products consist of the transactions, with effectiveness measured against service level agreements

- Example projects:
 - Administrative or Actuarial system conversion
 - Financial or Actuarial model validation
 - “Mock” assessment before “real” event
 - Pricing or re-pricing assistance
 - Underwriting manual and/or decision audit
 - Claims processing review and/or audit
 - Staff training or learning/development events
 - Catering for an office party

- Examples:
 - Claims adjudicated and/or paid by a third party
 - Medical underwriting performed by a third party
 - Monthly or quarterly reserves calculated by a third party Actuarial team
 - Claim overpayments identified and recovered by a third party
 - Inbound call center staffed by a third party
 - Outside counsel on retainer

- One time only or possibly repetitive?
 - If repetitive, consider long term implications in CBA.
- Should work be performed in house or by consultants?
 - Do resources exist in house?
 - Are consultants more skilled or less expensive “all in”?
 - Factor in the cost of internal staff support for consultants.
 - Consider the terms of the pricing structures carefully.

- How much do internal resources “cost”?
 - Salaries and benefits, rent, equipment & other overhead
 - Opportunity cost of other work not performed
 - Offset costs by “value” (could be \$0) of investment/learning of staff doing the work

- What are the time constraints for completion?
 - Can internal (or external) resources meet these constraints?

- Who is the audience for the work product?
 - Board of Directors? C-Suite? LOB management only?

- What is the most important decision dynamic?
 - Timely completion? Gaining external point of view? Budget?

- **Choosing a consultant – client’s perspective**
 - Evaluate experience with your specific project.
 - Ask about other qualifications. Understand capabilities even if services not needed today.
 - Check references and/or obtain internal staff recommendations.
 - Review any publicly available work products.
 - Compare price quotes and terms of engagement.
 - Understand how consultant will staff the work. Who will lead the project? How much internal support is required?
 - Beware of “add ons.”
 - Make sure bid covers internal staff training and/or access to retain work products, if desired.

- Choosing a client – consultant’s perspective
 - Evaluate experience with client’s specific project.
 - Understand limits on your own capabilities.
 - Evaluate whether the client will provide the resources and support for the project to succeed.
 - Assess the cultural fit with the client.
 - Is client looking for a trusted advisor/potentially long term relationship? Are you?
 - Are your success criteria the same as the client’s?
 - Does this appear to be a win-win relationship?
 - Negotiate on pricing structure to the extent you understand the client’s constraints and can help.

- Actuarial model validation
 - Client’s Board of Directors requested external peer review of model used in calculation of externally reported financial statement values.
 - Time frames very tight. Review required within less than a month during otherwise busy reporting period.
 - Required working with a consultant skilled in checking models and data quickly and efficiently. Work needed to be done “like clockwork”.
 - Client team made themselves available, even though they were very busy.
 - Daily calls with team and weekly senior sponsor calls.

Consulting projects – case study



- Fees not main concern, but set a per-hour but not to exceed \$X structure to allow for potential release of accrued expenses or “free work” in following year.
- Overall, very successful project.
 - Client received valuable input on their model’s calculations and data inputs.
 - Board of Directors was able to rely on the independent view.
 - Client worked closely with consultant to understand methodology and approach, so client could replicate the effort in the future.
 - Work completed on time and at well below \$X.
 - Consultant was able to build on an already solid relationship with client and was engaged in follow up work (using the “free work” allotment).

Consulting projects – case study



– Costs

- Consulting fees for the engagement (project team led by senior consultant, utilizing four junior consultants, with partner oversight).
- Minimal expenses.
- Internal staff time and support for consulting team.
- Senior leadership time for discussion of issues/findings.

– Benefits

- Engagement was responsive to Board's request.
- Client staff received training to replicate process.
- Client received validation modeling tools for future use.
- Client received insight into their model calculations and data inputs.

Illustrative Case:

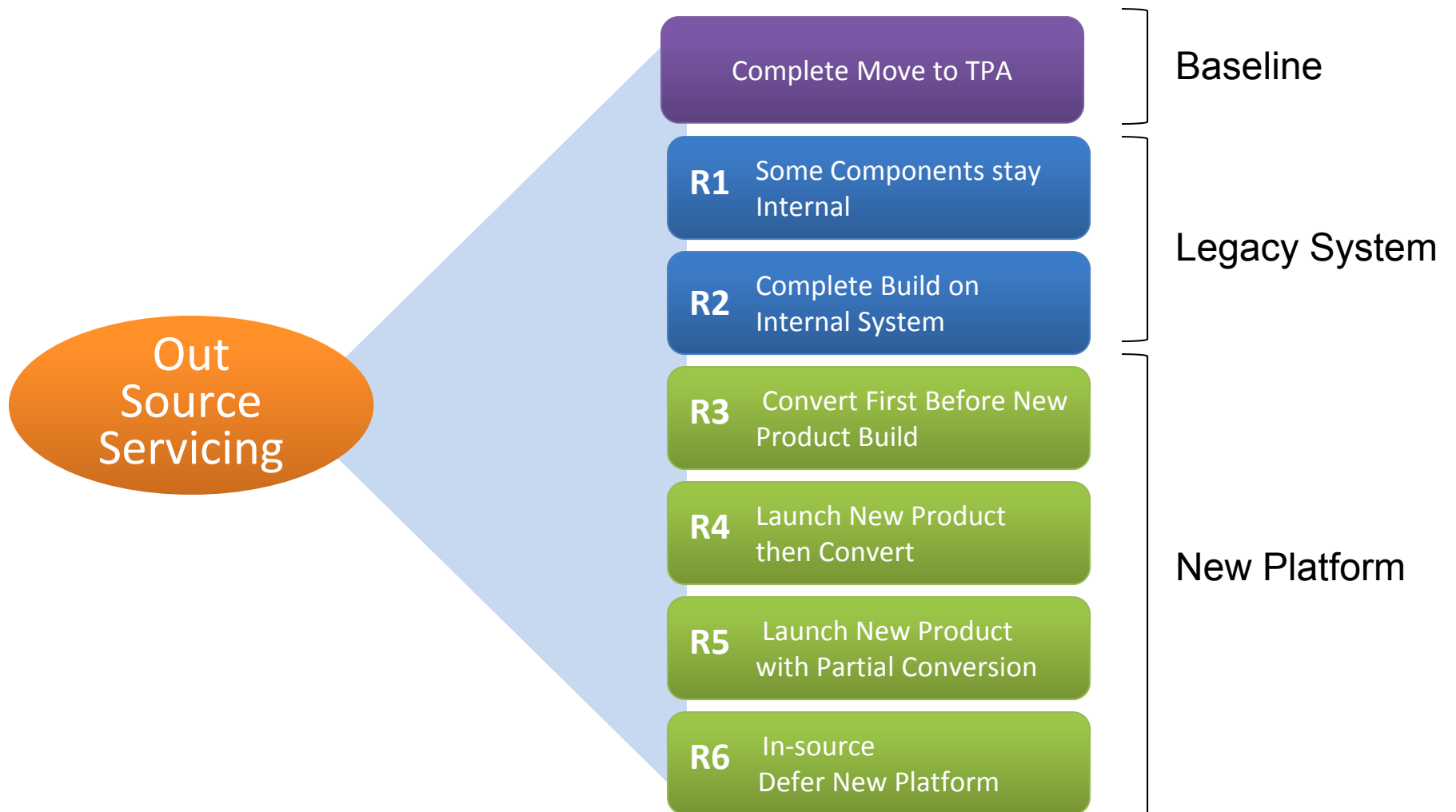
Potential Outsourcing of significant processes within LTC Division

Components of framework



- Laying Out the Groundwork
- Baseline and Summary of Findings
- Recommendation
- Appendix

Strategic Options



Project Charter



Project Name: Servicing Strategy

Leader: Rising Star

Project Description

Our Strategy mandates that we create deeper and more consistent Servicing capabilities.

Goal Statement

Develop a roadmap that defines the optimal approach for Servicing and Technology solutions to address the following project imperatives.

This project team's objectives are to:

Project Scope

In Scope:

Administration process from Pre-sales through Claims

Out of Scope:

All Non LTC products

Constraints / Barriers:

Timelines, Inter-related projects, contract negotiations

Milestones

Jun 15	Direction of the Business
Jul 20	Project team formed
Aug - mid Sep	Document Current and Desired Process, stakeholder awareness
Aug 11-14	Due Diligence
Mid-Sep - Nov	RFI and Demo potential tech solution providers
Dec - Feb	Identify strategic options and path/platform selection

Roles / Resources

Lead	Rising Star
Co-Sponsor/Champion	Business Leaders
Steering Committee	Key Business and Functional Leaders
Team Members	Names.....
Review Meetings	Steering Committee - Monthly or sooner if required Council Meetings – as required

Administrator Control:

Billing, Customized Processes, Fast/Capable Problem Resolution. Competitors (XZZ, MutualMan) currently in-source Critical Administration functions.

Product Ideation

The roadmap must solve for future needs. This requires the capability to easily integrate with external partners and upgrade features throughout the life.

Launch New Widget and Improve Process Capabilities

The roadmap includes the launch of new product with capability for multiple options and customization between customers and addition of new capabilities not currently possible on legacy system

Product Profitability – What is the impact by outsourcing

Fit to Technology Strategy

The roadmap should support the IT vision for all products. The system attributes must include the ability to rapidly configure new products, to integrate easily with existing strategic technology investments, to provide a positive end user experience, a strong database to support business analytics, and a scalable architecture for growth.

Organizational Knowledge, Depth, and Controllorship

The selected solution should optimize process while providing sufficient process controllorship. The system processes must allow access to data. The system must also provide necessary reporting to support infrastructure needs (GL, Actuarial, etc.)

Project Economics – measured by NPV (positive); IRR (> XX% Cost of Capital), and x year payback




Strategic Factors



High level view of each roadmap in comparison

- Its ability to meet defined strategic factors
- Near- and long-term looks
- In order of priority
- No Slam Dunks...requires dialogue

	Baseline	R1	R2	R3	R4
Risk					
Profitability					
Fit to IT Strategy					
Product Flexibility					
Process Improvements					
Controllershship					

	Fully Meets Strategic Need and Timing <3 yrs
	Partially Meets and/or Timing within 3-7 yrs
	Does Not Fulfill and/or Timing >7 yrs

Description

- Continue current Third Party Administrator
- Continue with current offering
- Invest \$ZZ MM in closing XYZ functionality gaps

How It Fits to Strategy

- **Control** - Maintain control of Process A only
- **Profitability** – Serves as baseline
- **Project Economics** – Serves as baseline

Risks / Concerns

- Control - Contract renegotiations & outsourcing of key Operations processes
- Ideation Secrecy - Potential leakage to competitors
- Current process Does not provide xx capability
- Knowledge/Depth/Controllershship - Does not build internal expertise or capabilities
- IT Strategy – Does not support single platform or provide easy integration

Heat Map

- Does not meet Strategic needs

	Baseline
Risk	
Controllershship	
Flexibility	
Process Improvement	
Profitability	
Fit with IT Strategy	
Project Economics	

R3: New Platform, then New Product



Description

- Invest \$xx MM's in closing functionality gaps in legacy system
- Drives fastest Ops/IT servicing savings
- Implement New Platform year X
- Convert Block for cost savings year Y
- New Products year Z
- Covert entire Administration block year Z

How it fits to strategy

- **Control** – Control all servicing by year X
- **Product Ideation** – Enables flexible product designs
- **Product Profitability** – ????
- **Ops Knowledge / Depth / Controllership** – Transfer knowledge early
- **IT Strategy** – Enables single administration platform
- **Project Economics** – Initial expense, Payback period x years

Risks / Concerns

- Control – New platform and large block of business to start
- Product - Delay in leveraging market need
- Org Knowledge/Depth/Controllership – New platform with complex processes building, Subject Matter Expertise from ground up
- Project Economics – Success depends on and implementation timing and budget

Heat Map

- Meets strategic needs; high risk / high reward by converting largest block first

	R3
Risk	Green
Controllership	Green
Flexibility	Green
Process Improvement	Green
Profitability	Green
Fit with IT Strategy	Green
Project Economics	Yellow

R4: New Platform, New Product First, then Convert



Description

- Invest \$xx MM in closing functionality gaps in Admin System – throwaway investment
- Allows Service experience to be “dialed” up
- Implement new platform and products year X
- Convert more products in year Y

How it fits to strategy

- **Control** – Control all servicing by year Y
- **New Product** – Enables flexible product designs
- **Product Profitability** – Modestly Accretive
- **Ops Knowledge / Depth / Controllership** – Drives product learnings early
- **IT Strategy** – Enables single integrated platform
- **Project Economics**

Risks / Concerns

- Project Economics – Success depends on RFP and implementation excellence
- Product Profitability – Worse than Baseline
- Product Ideation – Rigid product model
- Project Economics – High investment cost
- IT Strategy – Does not meet platform for LTC

Heat Map

- Meets strategic needs; lower implementation risk but delayed cost savings

	R4
Risk	Green
Controllership	Green
Flexibility	Green
Process Improvement	Green
Profitability	Green
Fit with IT Strategy	Green
Project Economics	Yellow/Red

Summary of Findings



	Baseline	R1	R2	R3	R4	R5	R6
Risk	Red	Green	Light Blue	Green	Green	Yellow	Yellow
Profitability	Red	Red	Red	Green	Green	Green	Green
Fit to IT Strategy	Red	Light Blue	Green	Green	Green	Light Blue	Yellow
Product Flexibility	Light Blue	Yellow	Yellow	Green	Green	Yellow	Green
Process Improvements	Red	Red	Yellow	Green	Green	Yellow	Yellow
Controllershship	Red	Green	Green	Yellow	Green	Yellow	Red

Best opportunity to meet strategic needs

Insights

Expense

Transition Necessities:

- Continue third party relationship over x years
- Potential \$y MM of throw-away money to continue growth of strategic product

Legacy System

- Continued long-term investment in legacy will drive costs higher over time
- Meets Controllershship , but does not meet future Ideation and IT Strategy needs





New Platform

- Meets or partially meets strategic factors
- Vendor RFI produced high level
- Project Economics affected by timing, and implementation risks

- **Validate new platform capabilities and costs through RFP (X – Y months) to better understand cost and timing**
 - Create RFP Team
 - Business Requirement / Scope of Work Development
 - Proof of Concept Demonstration
 - Supplier Visits
 - Contract Negotiation
- **Requests:**
 - Initiate Project and allocate funding to support RFP
 - Prioritize resource allocation
 - Initiate contract negotiations after
- **Risks / Concerns:**
 - Time, Money, and Execution

Tools used in the framework (“Appendix”)



-  Laying Out the Groundwork
-  Baseline and Summary of Findings
-  Recommendation
-  **Appendix**
 - Impact on Product Profitability
 - Additional Roadmaps with Strategic Factors
 - IT Cost Detail
 - Implementation Sequence Charts

Project Economics



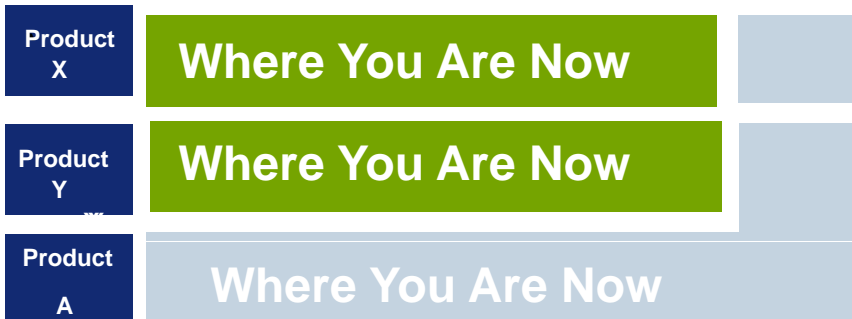
Roadmap	R1		R2		R3		R4	
Scenario	Low	High	Low	High	Low	High	Low	High
NPV (MM)								
Return								
Payback								

Key	
R1	Option Description
R2	Option Description
R3	Option Description
R4	Option Description

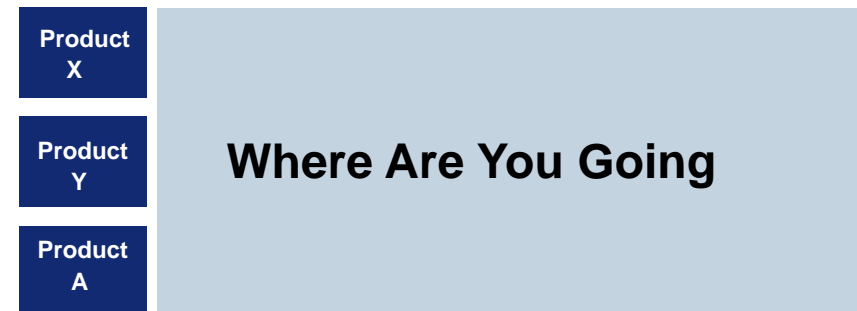
Product - Service Transition Strategy



Current Service Platform



Future Service Platform



Strategic Decision Levers

Differentiation

- Current supplier provides consistency, not differentiation
- Outsourcing creates market perception of lack of emphasis

Flexibility for Rapid Market Growth

- Implementation slow at TPA

Scalability to Individual Product Platform

Aligned to Company Technology Strategy

Product Economics

- TPA costs growing (pure variable cost)

Approach

- 20XX: Build & Integrate platform into existing IT infrastructure service in-house
- 20XX-YY: Transition current blocks to new platform
- 20YY+: Leverage new platform

Clear Economics

- X yr cost savings \$xx - \$yyMM
- IRR YY% - XX%
- ROE impact +VV% - ZZ%

Supplier Evaluation Criteria



Platform

Business Capabilities

- Existing functionality
- Speed to market for new products

Technology

- Fit to technology strategy
- Rapid product configuration
- Integration with existing structure
- Scalability
- Conversion expertise

Financials

Supplier

- Stability
- Acquisition potential

Administrator

- Project economics
- Product profitability

Critical Considerations

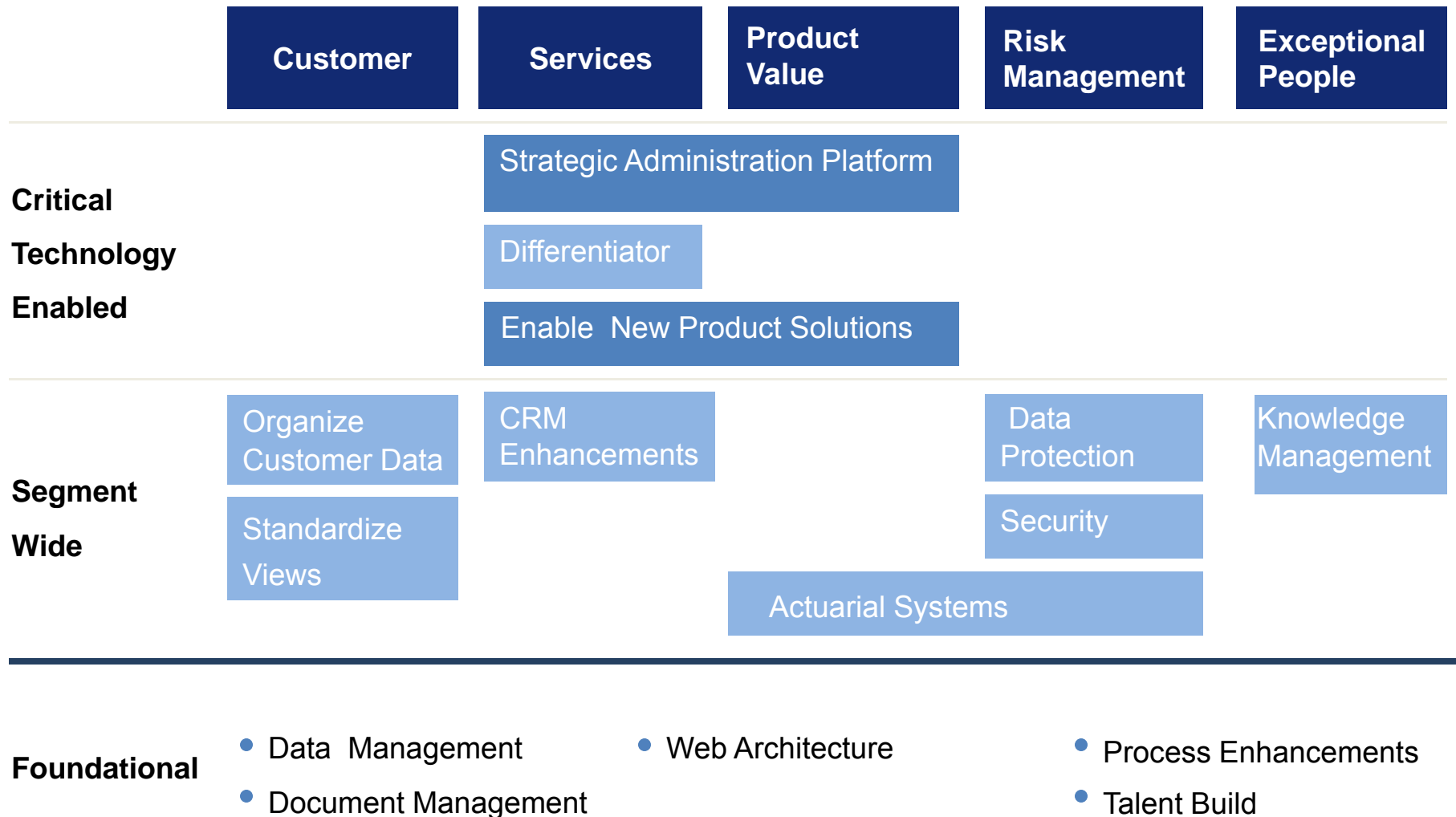
Potential Platform for Your Business

- Initial customization/design risk
- Ongoing support

Validations

- Due diligence
- Reference Checks

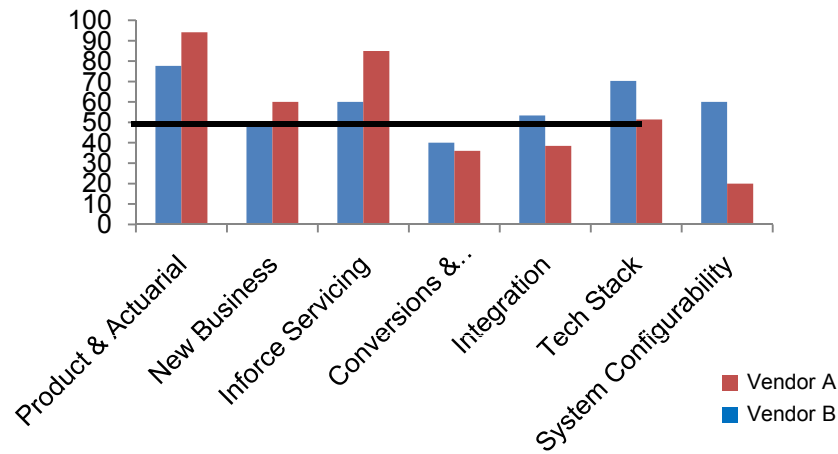
Technology Strategy Alignment to Business



Supplier Capabilities Comparison



Platform Scoring Summary



Vendor B

- + Existing capabilities with Platform
- + Robust product configuration engine (Product Factory) and rules engine
- + Modular, flexible, configurable system
- + New business and underwriting workflow
- + Strong infrastructure and a unique, flexible conversion approach
- Small, privately held company
- Requires minor to medium modifications in many areas to replicate company processes.

Vendor A

- + Demonstrated depth with product line
- + System used by key competitors – shared development potential
- + Able to support ideation requirements
- + Product configuration capabilities
- + Supports State Partnership requirements
- Company financials
- Still have some legacy technologies
- Implementation & documentation challenges
- To accommodate individual LTC would still require integration with multiple systems as exists today

Vendor C

- + Large, well funded company
- + Strong vendor relationship
- Significant system modifications required
- Only 65% required capability currently available
- Mainframe based

Vendor D

- + Well funded venture
- + Flexible technology architecture
- No recent/current LTC customers
- Target market: small to mid-tier carriers.
- Significant customization required
- No implementation/conversion experience

Most Critical Advantages for Final Two

	<u>Vendor A</u>	<u>Vendor B</u>
• Both meet our Strategic Factors	+	+
• Fit with IT Strategy / Modular, Flexible Platform		+
• Company Financials/Stability		+
• LTC Product Experience	+	
• Implementation & Experience		+
• Offering – Long Term Total Ownership Of Product		+
• Shared Development Costs	+	

Vendor B is the Right Strategic Supplier for Implementation

Program Spend Summary



Key Facts

Business Case/Objective: Insource Product Administration, Gain Control of Servicing , and Fully Exit TPA relationship by 20XX

Sponsor: Name(s)

Process Owner: Name(s)

Product & Channel Impacted: XYZ Product

Enabling Departments Assisting:

Operations, Product, Sales, Marketing, and IT

Major Deliverables:

- Completion of Feasibility Phases – 03/XX
- Base System Setup, Solution Design & Product Build – 7/XX
- Implement pilot on New Product – 12/XX
- Convert Remaining XX Block onto New Platform – 6/XX+1
- Convert YY Block onto New Platform – 12/XX+1
- Evaluate LTC Platform Conversion Options – 01/XX+2

Approval Date/Forum: Received at Board Mtg

Start Date: 4Q 20XX

Completion Date: 1Q 20YY

Key Financials

Total Program (\$MM)		2014		2015	
Total					

Payback: X yrs from launch **IRR:** XX%

Benefits

- Expense reduction: xx% Cost Reduction from Baseline over yy years
- Insourced Control over Servicing
- Installation of Scalable Platform for Individual Conversion

New Ongoing Expenses

- IT Maintenance Costs: \$XXXXK per year

CBA:
File attached

Final Recommendation & Ask



- Vendor Selection – Vendor B Platform
 - Start Contract Negotiations Now
- Seek Approval to Launch Implementation Phase Immediately
 - Secure Funding
 - Initiate Dedicated Project Team
 - Launch Feasibility Phase
- High Level Implementation Plan
 - Targeting Launch for during 3QXX

Capital Funding	2014	2015	2016	2017	2018
Vendor B (Low)	XX	XX	XX	XX	XX
Vendor B (High)	YY	YY	YY	YY	YY



Final Approval From Business Leadership