

## **OUTSOURCING: BE SELECTIVE, BE CAREFUL**

Over the last five years or more, outsourcing has been one of the big buzzwords of the commercial world. Outsourcing has been happening big-time, on the basis that an external provider can carry out a particular task or process at lower cost and/or better. The big advantage that an outsourcer has over its clients is typically lower staff costs, especially in manufacturing, but in service industries there may be better processes, underpinned by up-to-the-minute IT, as well. It also may be that the external provider has more experience, that the process or function is essentially its core business; in other words, it is an expert in its field.

In financial services, functions outsourced are typically administration and customer contact via call centres. Stretching the boundaries of outsourcing a little, some smaller life companies have for years used consulting actuary firms for pricing, valuation, etc work, and reinsurers and their medical directors for underwriting and claims input.

### **Outsourcing risk management**

But can you outsource risk management? Now let's be clear what we mean here. We are talking about outsourcing risk management functions that affect the mortality or morbidity bottom line. So if a life insurer issues policies under its brand name but insured by another provider (that carries out the necessary underwriting and claim functions and bears all the associated risks), then fine. It is equally fine if the fronting company triages apps it receives, accepts those cases that meet its criteria for an acceptable risk profile, and passes on the remainder to another insurer which 'labels' those policies with the first company's brand. (Incidentally, we may see more of this model in future as part of market evolution.)

But suppose an insurer, when outsourcing its 'administration', includes underwriting and claims in the deal. The aim is improved efficiency – lower costs, faster service to clients and brokers, better management information, etc. So staff productivity is important, as are sound processes – these two factors are inextricably linked. Also important are the requirements for medical and other evidence: they cost money and slow down the relevant process.

### **Mismatched objectives**

But hold on, there is a mismatch of objectives here. Baldly, the outsource firm is looking to do as little as possible whilst meeting the conditions (service level agreements etc) of the deal struck with its client; 'minimal', after all, is good for its own bottom line too. On the other hand, the client needs quality risk management. How is that going to work?

The insurer lays down underwriting and claims philosophies. The outsourcer applies them. Does it apply them well enough? Well, performance needs to be audited (naturally). That way the insurer gets a fix on the quality of decisions made on its behalf, including what evidence is being obtained and how that evidence is being used. So that's OK then.

Or is it? If there is a downturn in quality, the outsourcer is obliged to do something about it. How easy is it to bring that about? Poor-quality risk management is a major problem, in fact one at the core of the insurer's business; it's not one that can be solved overnight, and probably not over quite a few nights. Maybe the problem involves training and continuing professional development, something all good life insurers invest in heavily. You can tell the outsourcer where the problem is, but you can't tell it exactly how to solve it. Having lapsed seriously, can it be trusted, does it have the ability, to implement the necessary solution?

## **The risk to the brand**

Then there are those borderline decisions or those difficult cases that really test the consumer brand's values, the ones that determine which side of the line the case falls – like whether an app is accepted or declined; or whether a rated decision is at a level that makes the rate affordable/acceptable – or at a higher one above that means it's not; or whether a claim is paid or not. A company really needs the right sort of people making those decisions: people that believe in and 'live' the brand, not folk that just happen to be doing a job on behalf of company A (as opposed to company B).

Much of what is at issue here is about cost versus quality, and in our experience some outsource firms seem to know the cost of everything and the value of nothing. They are great at simplifying and speeding up straightforward *transactional* processes, but are found wanting in more complex ones, such as those involving decision-making. Objective, 'hard', left-brain good; subjective, 'soft', right-brain poor.

But it is also about risk management being at the heart of what an insurer does. Ostensibly this ought to be one of an insurer's core competences, and generally that assumption holds good. But given that underwriting and claims functions are so instrumental in shaping the customer experience, and thus determining the fortunes of the brand, why cede control of that to someone else? And then there's that mortality/morbidity bottom line. Again, why lose grip of that? After all, even plain life business is not as sure-fire profitable these days as it used to be.

Think about outsourcing risk management in another way. An outsource contract may last for five years or more. But the risk management environment is never still, not even for five months, let alone a period of years – changing risks, new risks, new imperatives for underwriting and claims. The potential for change and the need to respond to it needs to be addressed; it needs to be part of any risk management strategy. You wouldn't choose to manage how that change affects something so crucial via a third party that has only a superficial interest in the outcome. It sometimes seems that the relationship between product design, risk pricing, risk evaluation and claims handling is distant enough a sit is, without introducing something that makes joining up all the dots even harder.

## **Centre of excellence?**

Quite some while back we signalled approval of the concept of a 'centre of excellence' for underwriting – an external unit dedicated to risk evaluation applying the philosophy of its clients, and whose *raison d'être* is first-rate skills and risk knowledge (and, implicitly first-rate training of its staff). This would be outsourcing to an outfit that can do the job better, as well as at least matching cost-effectiveness. We still stand by that. Even though this third party would have no direct interest in the mortality etc performance of the portfolio created, the deal would make sense because it would be an organisation dedicated to risk management and to quality.

Most of what we have discussed in this article has happened; it's not hypothetical. With perhaps pressures increasing to outsource, maybe even to offshore locations, if you do go down this route, do so with care. Cede the right processes. Beware risk management issues; stay in control. Where risk management is affected, at least give your outsource partner a financial stake in the outcome.

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