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Harvesting Value from Closed Blocks

The Opportunity, Cost and Benefit Realizations of the Life Insurance Industry's Largest Untapped Asset

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ABSTRACT

What should a Life and Annuity company do with a closed block portfolio of complicated, benefit-rich, high-maintenance policies and contracts? The simple answer: *optimize.*

Closed blocks are an ideal target for companies looking to liberate financial and human resources.

Optimizing the value of closed blocks is a strategic imperative. Closed blocks are an ideal target for companies looking to liberate financial and human resources. Moreover, improving the margins on portfolios not actively sold has a positive impact on top and bottom line performance.

As elevated unit costs are a function of high expenses and low volumes, a particular subset of closed blocks stands apart, particularly ripe for address. These small, complicated closed blocks often share the following characteristics:

- Modest volumes of policies/contracts
- Products designed to meet the needs of a niche target market
- Harbor unique benefits and esoteric product features
- Demand expensive, highly skilled business people and custom technology solutions

This white paper provides closed block insights and discusses optimization tactics to help the Life and Annuity company maximize its return on closed blocks. It specifically defines the best solution to manage the most vexing closed block portfolios – effectively and efficiently.

In short, the optimal solution for closed blocks maximizes margin, unlocks latent value, and delivers capital to fuel strategic initiatives. The successful solution is rooted in preservation of the policyholder-carrier relationship, while leveraging technological efficiency offered by a modern solution.

Allowing the insurance company to maintain intimate customer contact and employ the power of a low-cost technical platform is the ideal mix of insurance company and outsourcing vendor capabilities. As such, the SaaS/ASP model is the most powerful solution for closed blocks – especially the portfolio of complicated, benefit-rich, high-maintenance policies and contracts.

PREMISE

Closed blocks are a fertile source of untapped financial and human assets that can provide Life and Annuity companies the opportunity to reduce costs and free up capital for strategic initiatives.

CONDITION

A closed block is loosely defined as a group of policies that are no longer actively sold and positioned for run out.

Many Life and Annuity companies have a number of closed blocks. A closed block is loosely defined as a group of policies that are no longer actively sold and positioned for run out. Improving margins on in-force blocks (especially on non-core portfolios not actively sold) has a positive impact on top and bottom line performance.

A number of drivers are responsible for the propagation of closed blocks. These include:

- **Ceased sales due to performance, such as:**
  - Poor pricing
  - Lack of scale
  - Capital constraints
  - Lapse rates
  - Mortality/morbidity
- **Changes in corporate strategy, like:**
  - Shedding or shuttering non-core assets
  - Demutualization
- **Regulatory changes**
- **Market shifts**
- **Mergers and acquisitions, primarily:**
  - Redundant systems and functions
  - Non-strategic portfolios
- **Technology and product evolutions:**
  - Development of IT innovations that make existing technology obsolete and promise efficiency
  - Product innovation requiring new and more robust system capabilities

LARGE VS. SMALL BLOCKS

Closed blocks come in all shapes and sizes, including large blocks of traditional products and small blocks of niche products.

Closed blocks come in all shapes and sizes. These include:

Large blocks of traditional products (sometimes referred to as "ordinary business")
Often these are relatively simple term, whole life or universal life product designs. The volume of these blocks may range from hundreds of thousands of policies to millions of policies. In addition, these blocks often carry massive reserves and account for significant recurring premiums.

For those portfolios of larger scale, the insurer has viable operational and financial alternatives.

- The carrier may maintain the block in-house. For this to be viable, the block must have sufficient scale to warrant ongoing investment.
- The carrier may outsource the block. Most outsourced vendors willingly assume large homogeneous blocks because they can leverage similar competencies across multiple carriers and realize economies of scale.

Small blocks of niche (complex) products
With its inherent complexities and relatively modest scale, a small closed block poses a challenge to the insurer: maximizing the block's value in light of its unique characteristics.

For small closed blocks, the insurer has the following characteristics to consider:

- Generally, these products are targeted to meet a specific market segment. They tend to have complex designs with certain "bells and whistles" designed to attract a particular customer.
- The volume of these blocks may range from a few hundred policies up to 100,000. Such compromised volume may be attributed to a limited target market, or that the product design is/was not widely accepted by the intended audience,
- Due to the nature of the products' benefits and provisions, these blocks typically require highly skilled resources to service them.
- Small blocks often operate on purpose-built, highly customized systems that tend to be non-core, non-strategic IT platforms.
- The customer base may be affluent with high service expectations.
- The portfolio may hold significant assets and/or hold potentially valuable client relationships.
- As these blocks increase in number, operational efficiency decreases and service teams become fragmented.

CARRIER CHALLENGES

There are two basic challenges with which carriers must contend when dealing with non-core, non-strategic blocks of business: focus and cost.

Due to regulatory changes, market shifts and product obsolescence, small closed blocks are an ever-increasing portion of a Life and Annuity company's portfolio. As mentioned previously, carriers must contend with non-core, non-strategic blocks of business. This creates two basic challenges:

- **Focus:** Diversion of a carrier's focus from product development and strategic initiatives.
- **Cost:** The carrier battles a cost structure that continues to increase over time, even though the block of business typically diminishes as time progresses. A number of factors contribute to this, including:
    - **Maintenance of Service Standards**
      The carrier must continue routine spending to maintain service standards to retain customers and safeguard its reputation.
    - **Proliferation of Manual Processes**
      Most system initiatives focus on expeditiously getting a product on the street for new business (open portfolio). Many "Day 2" system enhancements for closed blocks are delayed or canceled. Therefore, the business introduces spreadsheets and manual processes to compensate and offset the Day 2 backlog.
    - **Antiquation of Systems**
      Systems used to maintain these blocks of business often become obsolete and more costly to maintain as time progresses. In addition, the cost of maintaining the systems are not directly proportional to the number of polices on the system. **It costs as much to maintain a system for 1,000 policies as it does for 50,000 policies.**
    - **Increasing Costs of Technical Resources**
      Since the risks of losing institutional knowledge on these systems is significant, a carrier often pays more to retain these "technical experts" who are constantly lured by the attraction of newer and "more interesting" technologies.

ALTERNATIVES

The following two alternatives are suggested: optimizing value or outsourcing the business.

OPTIMIZING VALUE

It is widely accepted that contracting for outsourced IT and professional services is a cost-effective option for handling specified business functions and/or managing technical commodities.

Life and Annuity companies have various options to optimize the value of closed blocks.

- **Reduce investment in the legacy system.**
  A reduction in legacy system spending will deliver expense savings, and these savings can be redirected toward investment in new products and services. However, operational costs are adversely impacted, as workarounds and manual processes are introduced to compensate for the lack of IT investment.
- **Reduce headcount associated with the closed block.**
  A reduction in headcount will provide expense savings, but staff reduction can result in deteriorating customer service and a stressed workforce. However, compensating investments in technology can help offset full-time equivalent (FTE) reduction.
- **Perform business process reengineering (e.g., Lean Six Sigma).**
  This approach can deliver operational improvements and yield savings. However, real expense reductions come from optimizing processes through automation. If a commensurate IT investment does not accompany the business process reengineering (BPR) exercise, the gains are limited.
- **Sell the closed block.**
  Life and Annuity companies may not want to surrender the associated surplus and part with any of their customer base. They may be loathe to losing scale, cross-selling opportunities and the opportunity to convert the closed block to a better, more profitable product (or cost-effective platform).
- **Consolidate systems internally.**
  System consolidation requires converting policies to a common platform. The migration is often challenging (due to a lack of historical documentation, poor data quality, resource contention, etc.) and very costly — with large project overruns being the norm. Consequently, most insurers conclude that a positive business case cannot be made for converting a non-strategic block in runoff mode.
- **Outsource the block of business.**
  It is widely accepted that contracting for outsourced IT and professional services is a cost-effective option for handling specified business functions and/or managing technical commodities like data center, hardware, software, and business application support and maintenance.

OUTSOURCING BUSINESS

A carrier has a number of options available if it chooses to outsource a closed block of business.

A carrier has a number of options available if it chooses to outsource a closed block of business. Those options include:

- **Information Technology (IT) Outsourcing:** Delegating some (or all) IT functions to one or more external partner(s).

  While wholesale IT outsourcing (a.k.a. "Lift and Shift", Application Management Agreement, or ITO) to an offshore provider may reduce the IT wage cost component, many companies find certain business processes cannot be easily moved offshore. When sourced offshore, remote application management, language and cultural issues sometimes prove problematic.

- **Business Process Outsourcing (BPO):** Delegating some (or all) certain business functions to one or more external partners.

  Like IT outsourcing, selecting a BPO provider for commoditized business processing can reduce the wage cost component. However, care must be taken when choosing a BPO provider. Without the proper care and attention to detail, the carrier's loss of direct contact with its customer can lead to erosion in service, as well as a lost sense of "feel" for the insurance company's constituency.

- **Application Service Provider (ASP):** Providing remote access to business applications that are supported and hosted by the authoring third party. In this case, applications are single tenancy.

  OR

  Software as a Service (SaaS): Providing access to web-native applications that are hosted by an authoring third party. In this case, applications are multi-tenancy.

A qualified outsourced vendor can provide mission-critical applications in a secure, low-risk business arrangement with favorable price points and terms.

OUTSOURCING OPTIONS – A LIFE INSURANCE COMPARISON

	SaaS	**ASP**	**BPO**	**ITO**
What	Insurance business operations performed by insurance company personnel using business applications offered by the third-party outsourcer.	Insurance business operations performed by insurance company personnel using business applications offered by the third-party outsourcer.	A third party (on behalf of the insurance company) executes insurance business functions.	Information technology (or pure technical functions) are supported or managed by a third party on behalf of the insurance company.
Who	Candidates include: ▶ Sales force automation ▶ Client relationship management ▶ Web-based illustrations (run by authorized distributors of the insurance company) ▶ Web-based policy holder self-service transactions ▶ Web-based policy inquiry and on-line reporting	Candidates include: ▶ Illustrations run by authorized distributors of the insurance company ▶ Policy holder service transactions executed by insurance company staff ▶ Proprietary illustration and policy administration applications supported by the outsourcer	Candidates include: ▶ Finance / accounting ▶ Human resource management ▶ Investment management ▶ Customer care / call center support ▶ Underwriting ▶ Back office operation • Data entry • Premium services • Document management	Candidates include: ▶ Any or all parts of a SDLC practice area: • Coding • Testing • Re-engineering • Maintenance • Application development • Web site development ▶ Remote monitoring and maintenance, product support, IT security, network monitoring and management, etc.
How	▶ Underlying hardware and software platform supported by outsourcer in secure data center ▶ Proprietary third party software; right to use granted by third party	▶ Underlying hardware and software platform supported by outsourcer in secure data center ▶ Proprietary third party software; right to use granted by third party	▶ Either party may host underlying hardware and software ▶ Software ownership may reside with either party ▶ Professional services conducted by third party; may require licensed personnel	▶ Either party may host underlying hardware and software ▶ There is no ownership consideration of software

USING SAAS/ASP TO SUPPORT CLOSED BLOCKS

A holistic view of conversion — one that contemplates various hard and soft benefits — can often build a compelling and viable business case.

Employing the SaaS/ASP model to support closed blocks requires a conversion to the outsourcer's business platform. The business case for migrating policy data from a legacy system to a new platform historically has been problematic: The potential for exorbitant cost, daunting scope, and projected timelines are often deemed untenable.

As such, the perceived risks associated with conversions have induced insurance companies to maintain the status quo and abandon strategic platform initiatives that involve data migration. **Nevertheless, times have changed, and the benefits of closed block conversion are too great to dismiss.**

Moreover, a holistic view of conversion — one that contemplates various hard and soft benefits — can often build a compelling and viable business case. Such a conversion may include: risk mitigation for incumbent platform, reapplying highly skilled resources to strategic business initiatives, strategic consolidation platform and adding new products to the new technology platform.

A key aspect to the SaaS/ASP model is that the insurance company maintains complete control of the business processing functions and preserves day-to-day interaction with the client and producer. The benefits of this method have been shown through market research performed by Celent (the leader in research and consulting for IT in the financial services industry). Their study, summarized on the following page, included 10 areas of outsourcing concern.

OUTSOURCING CONCERNS

Though BPO arrangements can be beneficial, a recent Celent report indicates that many insurance carriers prefer to keep their customer service staff in direct contact with their constituents when outsourcing core services.

As previously mentioned, Celent used 10 areas of concern to survey insurance companies about outsourcing business. In their report, "Approaching the Boiling Point: BPO, SaaS in Insurance" (http://www.celent.com/reports/approaching-boiling-point-bpo-saas-insurance), Celent asked, "If your company were to outsource core policyholder and agent services, which of the following would be your top three areas of concern?"

A summary of the Celent findings indicate that the most desirable outsourcing solution should have the following attributes:

- Maintaining (and guaranteeing) service levels, possibly through binding Service Level Agreements
- Giving the insurance company control of critical functions (e.g., client facing processes like underwriting, call center and claims adjudication)
- Providing audited data security (SAS70, SSAE16), disaster recovery (redundant data centers) and business continuity (periodic joint testing)
- Allowing the insurance company to tailor its outsourced services to meet the needs of its customers; letting the outsourced vendor provide the IT commodity and augment services on request
- Allowing the insurance company to keep its customer service staff in direct contact with their constituents
- Partnering with an outsourcing firm with a strong marketplace reputation that also works behind the scenes using the insurance company branding
- Choosing an outsourcing firm with a proven delivery track record that is financially fit and provides an array of clients that are available for reference
- Embracing an outsourcing model that insulates the end-customer from the outsourcer so the insurance company can manage the ongoing client contact
- Structuring an outsourcing relationship that minimizes the displacement of insurance company personnel, while it provides for powerful cost savings
- Engaging with an outsourcer that provides services and solutions that meet or exceed state and federal regulations

SAAS/ASP — THE OPTIMAL SOLUTION FOR MANY

It is clear that the overall, best solution for closed blocks is one that maximizes margin, unlocks latent value and delivers capital to fuel strategic initiatives. The success of such a solution is often rooted in preserving the policyholder/carrier relationship while leveraging technological efficiency. Many insurance companies prefer to maintain intimate customer contact while employing the power of a low-cost, modern technical platform. **Though BPO arrangements can be beneficial, the SaaS/ASP model is often the most powerful solution for tapping the unrealized value inherent to closed blocks.**

GETTING STARTED

Insurance companies should take care when looking for a SaaS/ASP partner to help them harness value from their closed blocks.

To overcome the "do-nothing" inertia, and capitalize on the abundant benefits of closed block conversion, insurance companies should look to an outsourcing partner with the following attributes:

- **Portfolio rationalization experience**
  An assessment of business product portfolios establishes a business-centric modernization strategy and roadmap.
- **Proven conversion methodology**
  The creation of a realistic project plan and execution with ruthless precision.
- **Proprietary conversion tools**
  Complete control over the people and tools used to perform the conversion.
- **Modern technology**
  Reassurance that the business is not converting to something that is already outdated: the solution must be "evergreen."
- **Platform flexibility**
  The system must have the ability to adroitly handle a myriad of product nuances (due to system architecture and a vast library of technical components), business functions, as well as well-articulated processes. A flexible system will minimize conversion cost. In addition, a flexible system could potentially become a consolidation platform for many lines of business.
- **Support for individual and group products**
  The ability to span traditional business silos offering inherent leverage and economies of scale across an enterprise that helps drop unit costs.
- **Proven case studies and client references**
  Multiple references for production support of scores of Life and Annuity products minimizing risks and providing assurance that the outsourcing partner will deliver as promised.

ANDESA SERVICES — THE OPTIMAL PARTNER

Andesa Services provides comprehensive, integrated policy administration, plan administration and support solutions for life insurance and annuity carriers and producers.

Andesa began as a pioneer in the field of COLI/BOLI policy administration. Today, more than 30 years later, we partner with seven of the top 13 life and annuity carriers and several top brokers. We offer a suite of SaaS and ASP services, all backed by decades of proven, practical expertise in the industry.

Andesa's highly experienced team of U.S.-based professionals is made up of devoted client advocates who help industry leaders save time, reduce risk and tap unrealized value.

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For more information, please contact:

Ron Scheese – President and CEO
ron.scheese@andesaservices.com
610-821-8980

or visit our web site at andesaservices.com.