# fs viewpoint

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# *The art of letting go:* Middle- and back-office right-sourcing options for insurance investment management

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## *Point of view*

## *Today's insurers continue to face a tough economic environment. To remain competitive, we advise that they consider outsourcing parts of the insurance investment function—particularly the middle and back office.*

$1.4 trillion of insurance assets are now in the hands of professional asset managers, an increase of $500 billion since 2006.[1]

More than 80% of the CIOs who responded to a recent Goldman Sachs' survey indicated that they outsource a portion of their investment management to a third party.[2]

Based on PwC's 2014 CEO survey:

- 36% of insurance CEOs have a change program underway or completed in the organizational structure/design area in order to capitalize on global trends that they believe will transform their business. An additional 26% of insurers have concrete plans in place to do so.
- 39% of insurance CEOs have a change program underway or completed in the technology investment area to capitalize on global trends that they believe will transform their business. An additional 23% of insurers have concrete plans in place to do so.
- 28% of insurance CEOs have outsourced a business process or function in the last 12 months and 20% expect to do so in the next 12 months.[3]

**Investors and policyholders alike demand that insurers focus on improving transparency and increasing returns and margins. At the same time, insurers must maintain risk management practices, quality reporting, and client service in order to remain competitive and financially viable.**

Each insurance company has a unique approach to defining its investment management function. However, by and large, insurance investment management encompasses a significant portion of a company's overall operating costs, including investment accounting, financial reporting, IT hardware, and software, as well as the cost of relationships with third parties such as asset servicers, broker/dealers, and pricing services.

It is vital that insurers explore new ways to transform the investment management function to meet the following challenges:

- Deliver cost-effective technology and operations.
- Increase trust and transparency.
- Grow and leverage human capital.
- Improve global reporting.
- Navigate risk and regulatory compliance.

**Outsourcing key insurance investment functions—particularly middle- and back-office functions—is a viable solution that insurers should seriously consider.**

In our view, insurers should focus on the middle- and back-office functions to help determine the kind of operating model that will be cost effective, enable growth and expansion, address parent-company and/or third-party needs and challenges, and address both risk and compliance challenges from internal management and regulatory bodies.

Even in large insurance carriers where economies of scale make internal specialization feasible, there may be situations in which they can still benefit from expert knowledge in certain asset classes. For example, outsourcing these functions can help insurers focus on their core business and gain additional flexibility with respect to expanding or disposing of asset classes and/or portfolios.

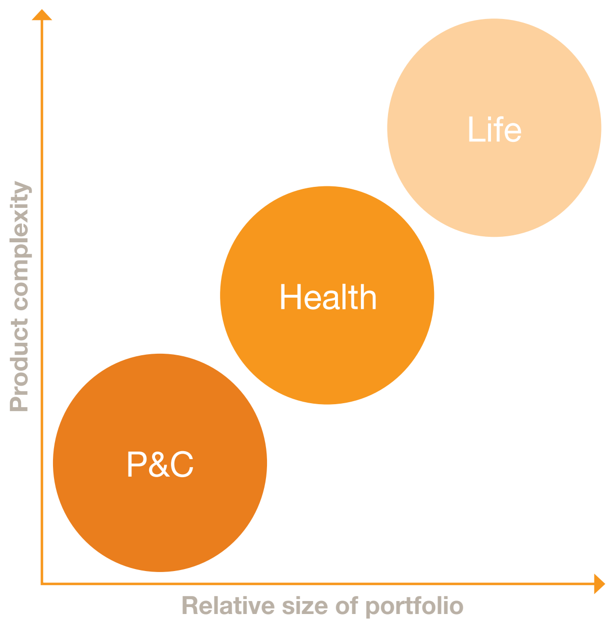
1 Patpatia & Associates, "Insurance Asset Management Annual Survey 2012," hedgeworld.com, accessed March 13, 2014.

2 Goldman Sachs, "Growing but Tempered Optimism: GSAM Insurance Survey," April 2013, www.goldmansachs.com, accessed March 13, 2014.

3 PwC, "Good to grow: 2014 CEO survey," January 2014, www.pwc.com.

*The desired right-sourcing approach is usually dependent on the size and complexity of the insurer's investment portfolio.**

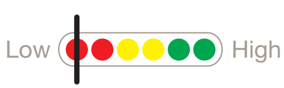
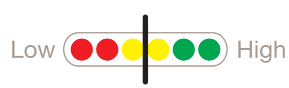
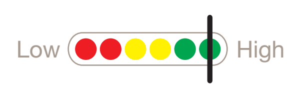
**Different types of insurers face diverse challenges that drive their rationale for a build, buy, or outsource decision. Our experience tells us that size and complexity of the investment portfolio all influence the desired right-sourcing approach.***




* We define right-sourcing as the process of arriving at the optimal service delivery model for the insurance investment management function.

| | |
|---|---|
| **Property and casualty** | Property and casualty (P&C) insurers are typically looking to reduce costs, manage regulatory and operational risks, grow profitably, and diversify their portfolios to find returns in a low-interest-rate environment. As they work to achieve these goals, P&C insurers continue to incur the costs of maintaining or upgrading old technology. Insurers face increasing personnel costs because many are in geographic locations with limited talent pools. These costs and talent constraints are more acute for smaller P&C insurers. |
| **Health** | Health insurers face similar challenges to P&C insurers. In addition, they are now focusing significant time and attention on regulatory mandates such as the Affordable Care Act and corresponding business growth. As a result, many health insurers are exploring how to outsource certain non-core competencies. |
| **Life and annuity** | Life and annuity carriers have some additional challenges relative to P&C and health insurers. These include:<br>• Complex duration matching.<br>• Risk-based capital limitations.<br>• A more diverse portfolio asset mix.<br>• Separate account pricing, trading, and accounting complexities.<br>• Typically have larger investment balances to support the capital needs of life insurance products.<br>As a result, the investment management function and its associated accounting and reporting are much more complex and costly than for P&C and health. |

## *We see industry leaders typically choosing among three different approaches to improve middle- and back-office operations for the investment management function.*

| | *Incremental approach* | *Back-office only approach* | *Outsource (lift out) approach* |
|---|---|---|---|
| |   |   |   |
| **Key considerations** | • Leverage internal operations and technology capabilities with an application-service-provider (ASP) model. | • Outsource back-office functions and technology.<br>• Link provider to the in-house applications, such as the portfolio and trade-order management systems.<br>• Provider's personnel work in conjunction with the internal operations staff. | • Outsource the middle- and back-office operations. Transfer or reassign staff, processes, and technology to the providers.<br>• Each provider handles technology migration to existing or industry platforms.<br>• Integrate insurance investment management personnel into the provider's operations.<br>• Insurer's investment manager retains responsibility for operational performance review and strategic management decisions. |
| **Insurer suitability** | • Preferred for insurers that have scale and talent, but do not wish to relinquish control of their operations. With this approach, insurers can gain some cost efficiencies and take advantage of vendor platforms, support, and disaster recovery plans. | • Preferred for insurers that have more straightforward portfolios, are looking to reduce operational risk, and want to take advantage of the vendor's platforms, resources, and support. | • Preferred for insurers looking to grow and diversify, acquire or dispose of businesses, and that have unsustainable existing infrastructure. |
| **Impact** | Incremental impact<br>  | Significant impact<br>  | Transformational impact<br>  |

***Once an approach is identified, it pays to invest time and effort up front to factor these key insights into transition planning.***

**Based on our experience working with insurers, we have established the following key recommendations for outsourcing:**

- Establishing a target operating model **prior to** making a right-sourcing decision increases the likelihood that potential vendors meet the established goals.
- Focusing solely on a provider's technology infrastructure when reviewing proposals can be a mistake and may sacrifice important considerations regarding customer service.
- Addressing retention and human-resource issues during migration planning is imperative. Successful migrations occur when the organization is forthright and open with its employees.
- Realizing additional front-office benefits is possible once the organization has migrated. Often, the additional benefits and "nice-to-haves" are identified after the deal.
- Bringing the front office into service-level agreement negotiations can improve services and timeframes beyond the levels currently provided by middle- and back-office support functions.
- Many insurers do not have sufficient controls around their vendor-management functions. A third-party risk management program should govern outsourcing. More information can be found in PwC's "Significant others: How financial institutions can effectively manage the risks of third-party relationships."[1]
- A thorough business case—including internal rate of return or a multi-year evaluation—should be performed up front and agreed upon with C-suite management. In our experience, failure to do this is the single largest barrier to success.

1 PwC, "Significant others: How financial institutions can effectively manage the risks of third-party relationships," September 2013, www.pwc.com/fsi.

***Based on our experience, we have developed the PwC Insurance Investment Management Right-Sourcing Framework.***

**Our approach helps insurers design an outsourcing approach to successfully transform middle- and back-office functions. Key steps include:**

- Understand the drivers for organizational change.
- Define and develop outsourcing objectives.
- Build consensus and support for outsourcing with leadership and boards.
- Develop an implementation plan with actionable recommendations.
- Drive and manage change during implementation.
- Perform successful, ongoing vendor management.

### 1 Define drivers and explore right-sourcing options.

- Understand the primary reasons for right-sourcing.
- Understand which business units and functions are impacted.
- Understand who should be involved in the decision-making process.
- Understand industry options, budget, and timeframe.

### 2 Capture current state.

- Define operational workflow and perform system analysis.
- Document products, services, functions, and processes.
- Document risks, issues, and challenges.

### 3 Determine appropriate solution and build the business case.

- Perform readiness assessment and determine appropriate solution.
- Perform quantitative and qualitative analyses to estimate benefits.
- Articulate the cost and benefit analysis to key stakeholders.
- Develop risk mitigation plan.
- Build standards and controls into the business case.

### 4 Select third party for right-sourcing relationship.

- Define scope of services.
- Issue request for proposal (RFP).
- Evaluate RFP responses.
- Conduct due diligence and select servicer.
- Finalize contract.

### 5 Develop and drive transition plan.

- Develop and track milestones and key dates.
- Implement service level agreements established in the vendor contracts.

### 6 Perform ongoing operational performance management.

- Implement conflict management plan.
- Establish key performance indicators.
- Perform regulatory environment assessment.

*When implemented effectively, outsourcing empowers insurers to keep their focus on their core mandate—increasing portfolio returns while reducing risk and remaining competitive.*

**The table below illustrates four separate benefits insurers can gain from outsourcing.**

**Gaining an economic advantage:**

- Ability to diversify investment portfolios while continuing to meet regulatory expectations through use of external specialists.
- Increase predictability of costs through standardized pricing.
- Shift system development costs to a third party, removing the need for large, upfront capital outlays.

**Gaining flexibility to focus on core business activities, including:**

- Product innovation (depth and breadth).
- Investment performance.
- Distribution channel improvement.
- Risk management.
- Client segmentation.
- Market expansion.

**Acquiring standard industry technology, including access to:**

- Ongoing maintenance and upgrades.
- Integrated global back-office capabilities.
- Back-up facilities and scalable technology for business continuity.

**Improving quality through standardization:**

- Gain specialized resources for investment operations processing and associated technology requirements.
- Produce timely and improved regulatory and compliance reporting.
- Automate labor-intensive activities, thereby reducing error rates and failed trades.
- Free up in-house IT staff from routine tasks so they can focus on strategic development activities.

*Outsourcing is a difficult process and gaining a return on investment takes time. However, there are effective ways to overcome these challenges.*

| | |
|---|---|
| **Challenge #1:** | Each of the following steps can pose tremendous challenges—any one of which could derail the entire effort and put the insurer's reputation at risk. These steps include securing funding; choosing a vendor; negotiating a contract; shifting whole business processes; absorbing, redeploying, or eliminating human capital; and building a relationship with a vendor to respond quickly to company needs as they arise. |
| **Potential solution:** | To overcome these challenges, we recommend that an insurer work with an industry service provider that can advocate for the organization's interests. The service provider can help an insurer to address transitional challenges; build in mechanisms to measure and manage costs during and after the migration; think about platform scalability for taking on new asset types and higher volumes; and can focus on retention of talent that best functions in a newly outsourced operating environment. |
| **Challenge #2:** | Many efforts to outsource some or all of the investment management middle- and back-office functions take anywhere from several months to a couple of years to complete, depending on the size and complexity of the portfolio and the number of functions to lift out. |
| **Potential solution:** | It is essential to clearly manage leadership's timeframe expectations. During the timeframe, address the more challenging aspects head on, putting in place solutions to resolve long-term issues while moving forward. Sequence the lift out by area or asset type to empower small successes, keep momentum flowing, and to keep leadership and key personnel invested in a positive outcome. |
| **Challenge #3:** | Many outsourced business processes show a rapid return on investment. In contrast, investment management outsourcing initiatives can have a negative return on investment during the transition phase because two platforms may be running for a short period of time (legacy and outsourced). |
| **Potential solution:** | Leadership teams should be fully informed that a positive ROI will likely not be realized until at least one-to-two years after onboarding is complete. Part of the value proposition must be measured over a longer time horizon—as much as five to ten years. Inorganic factors should be included in the value comparison (fee avoidance, acquisition and disposition of business lines, disaster recovery risk avoidance, allocated cost reductions, etc.). Tap into the creativity of service providers who are becoming increasingly innovative in helping clients more quickly realize positive returns. |

# *Competitive intelligence*

*Our observations of industry practices.*

## *Maturity of an insurance investment management function varies by the type, size, and complexity of the investment portfolio.*

### We have seen the following examples in the industry:

| Elements of the investment management lifecycle | Large life insurer | Small P&C insurer | Large multi-line insurer |
|---|---|---|---|
| **Operations, data flow, communications** | Insurer uses an industry-leading, application-service-provider (ASP) hosted, data-router solution with close attention to leading industry protocols. Insurer works actively with the vendor to update and manage the solution. Controls over the confirmation, clearing, and settlement process are tight and proactive where possible. The corporate-action process is well controlled and documented. | Third-party management of operations reduces the workload and resource requirements of the insurance investment management function. Activities do require certain consultation and consent from the insurer. | Operations are well controlled, and an industry-leading data-router solution is installed/managed in-house. Updating protocols is more time-consuming, but the insurer easily controls technology solution upgrades. |
| **Data analysis/repository** | Centralized repository captures complete portfolio positions and reporting needs, as well as provides data to analytics, performance, and compliance engines. | Files are stored regularly, and are reconciled with third-party custody position files on a semi-regular basis for accuracy. | Centralized repository is well managed and tightly coupled with an accounting tool for both parent-company reporting and third-party reporting. |
| **Accounting/reporting** | Each schedule type (such as real estate, mortgage loans, marketable securities, private equity, and derivatives) has its own accounting and reporting solution, and the insurer hosts each solution. | Reporting files are produced by a third-party-asset servicer, and sent monthly or quarterly to the insurer with Schedule-D-ready balances and ledger-ready entries. | Market leading vendor solutions are used with an ASP-support model, providing a solid reporting infrastructure at reduced cost. |
| **Portfolio management** | Portfolio rationalization has tightly aligned portfolios with underlying products, capital needs, risk profiles, and general duration. | Primary drivers are NAIC compliance, capital preservation, and minimizing operational risk. | Both internal and external portfolio advisors manage a large number of portfolios that are tied to products. There are no recent portfolio reviews. |
| **Order management** | An industry-leading, order-management platform is used for most transactions. Industry-leading platforms for non-Schedule D assets (Schedule A, B, and BA) are prevalent. | Portfolio management and operations are outsourced to a third-party vendor. Risk appetite, exposure, and other investment guidelines are provided to the vendor, and investment trades are reviewed and approved by the insurer, as agreed upon in the contract. | An industry-leading, order-management system with disparate systems for non-Schedule D assets is used. |

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# A framework for response

*Our recommended approach to the issue.*

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## *Define drivers and explore right-sourcing options.*

**During this step, it can be helpful to explore a broad range of questions to identify the stakeholders, assess organizational capabilities, and understand the goals and constraints that are in play.**

For example:

- What are the primary reasons you are looking to outsource? Is it about gaining investment knowledge, seeking specialized strategies, reducing risk, and gaining access to resources? Or is it just about cutting costs?
- Which business units and functions are impacted?
- Who should be involved in the decision-making process?
- What are the industry options, budget, and timeframe for the project?
- How much operating model change is feasible?
- Which products and processes should be considered for change?

**Our experience shows that asset size and type of business (P&C, life, or health) can directly impact the approach that you are likely to choose.**

Goals of outsourcing based on size/type of business commonly include:

| Large life and health insurer | Large P&C insurer |
|---|---|
| • Enter new investment markets.<br>• Increase internal rate of return.<br>• Reduce costs.<br>• Reduce exposure to operational risk. | • Reduce costs.<br>• Generate measurable, predictable returns.<br>• Reduce compliance costs.<br>• Reduce exposure to operational risk. |
| **Small life and health insurer** | **Small P&C insurer** |
| • Gain access to broader range of investment capabilities and expertise at reasonable cost.<br>• Reduce exposure to reporting misstatement.<br>• Focus on product and operational excellence. | • Gain access to broader range of investment capabilities and expertise at reasonable cost.<br>• Improve regulatory compliance.<br>• Reduce exposure to reporting misstatement. |

**Clearly defined goals for the investment management function should serve as the basis for developing an outsourcing approach.**

**Life insurance carriers** typically accumulate the largest dollar amount of invested assets, because of the asset-intensive nature of their products, and the duration of their policies, such as whole life insurance and annuities. Assets of life insurers are primarily invested in medium- and longer-term, taxable, fixed-income investments. A more significant portfolio can move to structured products, real-estate, mortgage loans, private equity, and derivatives (both exchange-traded and over the counter). These can get very complex, and consideration for outsourcing must be more thoroughly examined.

**Property/casualty insurers** typically have shorter term policies, which lead to shorter asset durations, along with stricter NAIC designations on investment quality. The invested assets are often more liquid (predominantly fixed income), more straightforward, and less volatile. This puts more of a premium on cost and quality of execution because insurers want to process the same securities and volumes with fewer touch points at a lower cost.

## *Capture current state.*

**Before building a business case and selecting a service provider, insurers should assess the current state of their operations.**

A current-state assessment enables the creation of a strategic plan that addresses the strengths and weaknesses of the institution.

| Considerations and key questions | |
|---|---|
| **Objectives** | • On asset-class basis, assess what you do and do not do well. For example, how confident are you in your emerging market and multi-currency capabilities?<br>• Document current-state functions, products, and services.<br>• Identify operational challenges and costs.<br>• Develop a baseline of the current operating model. |
| **Key tasks** | • Review key processes with leaders and key personnel responsible for each process.<br>• Analyze key challenges, including time, resource allocation, and regulatory risk areas.<br>• Review management letter comments, audit, SSAE 16 comments, and other challenges in the existing processes.<br>• Perform a full costing analysis. |
| **Sample deliverables** | • Current-state operational workflow and system analysis.<br>• Documentation of products, services, and functions.<br>• List of organizational business units that are in scope.<br>• Process documentation.<br>• Highlights documentation of risks, issues, and challenges. |

## *Determine appropriate solution and build the business case.*

**A readiness assessment allows an insurer to understand its appetite for change and to determine the appropriate approach to right-sourcing the insurance investment management function.**

The following are sample questions for consideration:

*Are you comfortable allowing a third party to handle your data?*

*What is the institutional appetite for accessing third-party capabilities in order to innovate?*

*What are your desired cost efficiencies?*

*What is your tolerance level for third-party operational risk?*

*What is the scale of the insurance investment management function? Assets under management? Product types? Portfolio count?*

*What challenges or risks would an application service provider or outsourced model help to address?*

# *Determine appropriate solution and build the business case (continued).*

| | *Incremental approach* | *Back-office only approach* | *Outsource (lift out) approach* |
|---|---|---|---|
| | Front office / Middle office / Back office / ASP | Front office / Middle office / Back office | Front office / Middle office / Back office |
| **Key considerations** | • This can be a "first step" to a more transformational change, and it can provide leadership with a baseline to show value for investment more quickly.<br>• Successfully moving to an application-service-provider (ASP) model can enable the insurer to put in place certain elements of transformational change whether or not the insurer moves forward. | • Typically, insurers with less relative complexity (generally, more P&C and some health insurers) have increasingly moved to this model, given their more straightforward portfolios, more compressed profit margins, and desire to focus talent and expertise elsewhere in the business. | • Typically, more life- or health-focused insurers have expressed interest, but all insurers are increasingly looking at options. |
| **Representative examples** | • Insurers with lean shops or those that had challenges with prior implementation efforts. | • Insurers that have had challenges with external or management reporting.<br>• Insurers that have key personnel dependencies in the accounting and reporting areas.<br>• Insurers that are looking to more fully outsource other capabilities, but would like to move forward incrementally. | • Insurers that are looking to expand their service offerings outside of the insurance parent company to third-party retail and/or institutional clients.<br>• Insurers that are looking to more actively acquire or shed certain portfolios and businesses, and would like to more quickly integrate or eliminate portfolios.<br>• Insurers that are looking to implement a variable-costing model, with less debate with the parent company on allocated costs and chargebacks. |
| **Impact** | Incremental impact<br>Low High | Significant impact<br>Low High | Transformational impact<br>Low High |

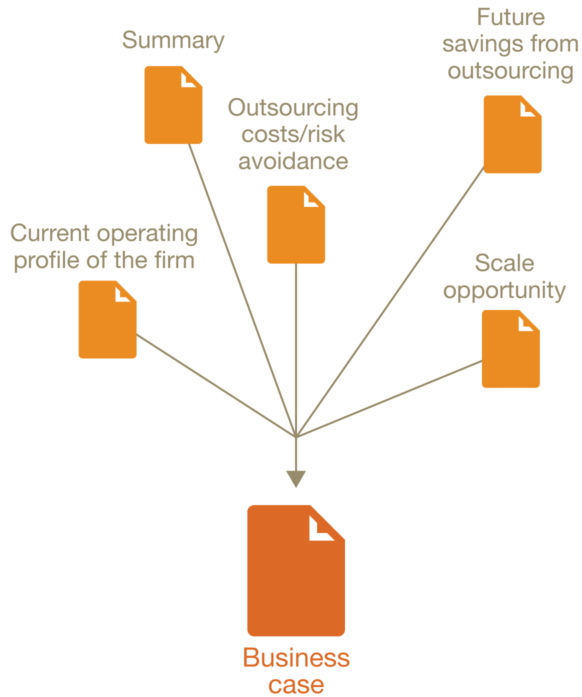
# *Determine appropriate solution and build the business case (continued).*

**Qualitative and quantitative benefits should be assessed and prioritized based on current and future business objectives.**

Positive return on investment is not necessarily the primary objective for every insurer. In some cases, the project may be worthwhile because it boosts competitiveness. The business case should tie directly to the goals defined previously.

**In our experience, the most effective business cases clearly address what is at stake and articulate the business benefits.**

## Business case example




**Describe how project aligns to organizational strategy**

- Use empirical data—customer, market, and other industry data—to support and explain how the project will impact long-term performance.
- Articulate why these outcomes are needed to support strategic enterprise-wide goals, and explain the potential risks of inaction.

**Articulate expected benefits**

- Measure at least part of the value proposition over a longer time horizon—typically 5 to 10 years.
- Quantify how the project will impact business units, operations, IT, and the organization's ability to comply with current and future regulatory requirements.
- Consider expected future workload based on growth targets.
- Capture intangible benefits such as improved customer service.

**Analyze cost and funding needs**

- Project the lifetime cost for different service providers and in-house solutions across the front, middle, and back offices.
- Communicate the results of cost and benefit analyses to key stakeholders to secure resources for the life of the project.

**Assess risk and identify alternatives**

- Involve key business decision makers and risk managers in the risk assessment.
- Build standards and controls into the project plan.
- Consider all alternatives, including service providers and other external partners.
- Be mindful of the need to retain sufficient expertise to be able to recognize when corrective action is necessary.

## *Select third party for right-sourcing relationship.*

### 1

**Define scope of services.**

- Clearly articulate proposed outsourcing plan.
- Develop business and IT requirements.
- Develop platform criteria.

### 2

**Issue request for proposal (RFP).**

- Prepare shortlist of potential vendors.
- Draft, finalize, and issue RFP.

  Insight: One area that insurers often overlook is getting the right metrics in place to provide cost transparency and to manage operational risk. Include both cost and control metrics in the RFP.
- Develop scoring metrics and a methodology.

  Insight: Include measurement of service levels, scalability/ flexibility, experience, and technology.

### 3

**Evaluate RFP reponses.**

- Evaluate servicers based on criteria set out in RFP. Score and analyze responses.

  Proven and measurable service levels: Are processing platforms well documented and controlled? Are there standardized metrics for trade fails, order fulfillment, cash reporting, reconciliations, and pricing exceptions?

  Scalability and flexibility: Do platforms provide for flexibility as new products evolve?

  Experience: Is there a proven track record of clients with industry peers? Have regulators uncovered any issues?

  Technology: Is the user interface convenient? Can it support multiple transactions?
- Perform pricing analysis. Is pricing clear and transparent? Can it be easily compared to competitors?
- Conduct executive analysis of responses.

### 4

**Conduct due diligence and select servicer.**

- Conduct onsite due diligence at the vendor's location to assess its ability to meet operational, risk, and regulatory requirements.
- Finalize winning vendor selection.

### 5

**Negotiate contract.**

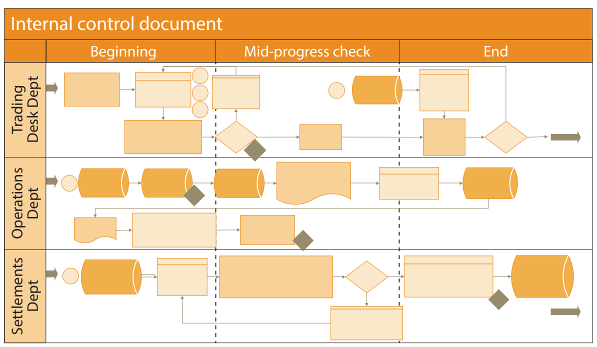
- Include explicit initiation, review, ongoing management, and potential termination details in the contract.
- Develop service level agreements (SLAs).

  Insight: Bring the front office into SLA negotiations. Services and timeframes can often be improved beyond the levels currently provided by middle- and back-office support functions. Include "claw-back" provisions for failure to meet SLAs.
- Define operational performance metrics.
- Agree on economic penalties if the service provider fails to meet dates and/or milestones.

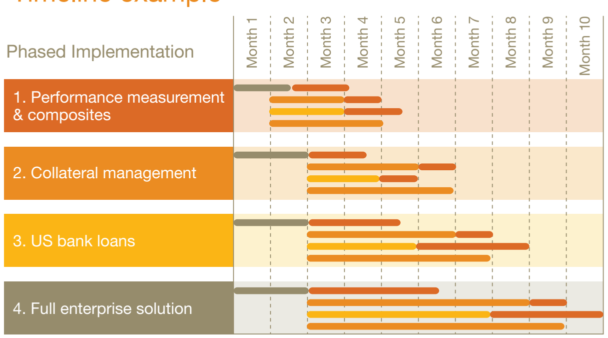
# *Develop and drive transition plan.*

**According to PwC's 17th annual global CEO survey, 59% of insurance CEOs see the limited availability of skills needed as an organizational threat.[1]**

Current state/target opportunity model example




Timeline example




1 PwC, "Good to grow: 2014 CEO survey," January 2014, www.pwc.com.

## A clear roadmap, disciplined project management, and a thoughtful communication strategy are important for keeping the implementation plan on track.

Key steps include:

- Establishing clear implementation dates and milestones.
- Holding the service provider to the SLAs established in contract negotiations.
- Measuring and managing performance.

## Consideration: Assess the impact of change on people.

It is important not to underestimate the complex and widespread impact the implementation will have on employees. Assess how the organizational structure and people's capabilities will be impacted by the changes, and develop a strategy for retaining, retraining, or planning for headcount reductions.

- Identify top performers who should either be retained to help manage and review the activities of the outsourced function or relocated to other parts of the organization. Are the right resources with the appropriate skills appointed in key positions?
- Prepare for challenges, such as addressing morale issues in the face of headcount reductions or job changes. Do employees feel personally connected to their jobs, teams, and/or the organization? Have you established and communicated clearly defined career paths, staff development, and succession planning?

# *Perform ongoing operational performance management.*

**Govern outsourcing with a third-party performance and risk management program. As part of that program, the vendor(s) selected for investment asset management should be assessed to determine the appropriate monitoring and control requirements.**

**More information can be found in PwC's "Significant others: How financial institutions can effectively manage the risks of third-party relationships."[1]**

### An outsourcing arrangement can only be successful if ongoing management is combined with periodic deep-dive reviews.

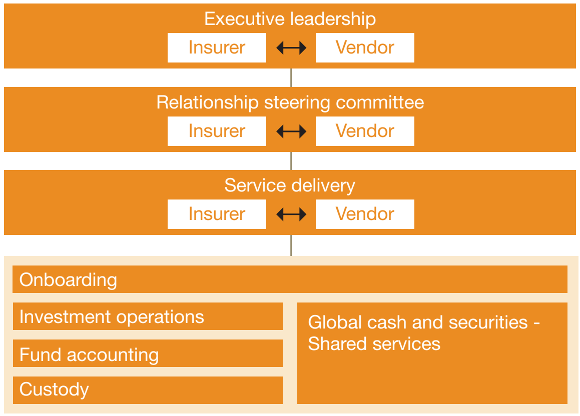
### Ongoing management should include items such as:

- Coordination of vendors in cases where multiple third parties are managing assets.
- Communication and implementation of changes as carrier needs evolve.
- Conflict management. There should be a clearly articulated policy of how the investment manager addresses conflicts between different clients in a manner that is fair to all parties involved, especially if some clients are also affiliates of the investment manager. Appropriate conflict management is especially critical if the investment manager also has a securities broker-dealer affiliate that transacts business with the insurer at the investment manager's direction.
- Determination and agreement with the vendor on key performance and risk indicators that both parties will submit to managing and maintaining on a regular basis (monthly/quarterly/as needed).
  - Note: Such measures should be managed along with non-performance penalties or incentives to promote adherence to the service agreement.

### Periodic deep-dive reviews should include:

- Periodic risk-based reviews of the vendor(s).
- Risk and control self assessments by business and functional groups.
- Reviews of the regulatory environment and the expectations of regulators. Identify regulatory changes that may impact the organization and respond appropriately. Pinpoint areas of uncertainty with respect to regulatory expectations and seek clarification.
- Reviews of all aspects of the contracted services, including service levels and key performance indicators, to adjust for external factors such as new business acquisitions, new products, new regulations, or new markets.

Governance model to assist in vendor management example




↔ = Some functions and positions may be transferred to vendor depending on the approach to outsourcing chosen by the insurer.

1 PwC, "Significant others: How financial institutions can effectively manage the risks of third-party relationships," September 2013, www.pwc.com/fsi.

*www.pwc.com/fsi*

***To have a deeper conversation, please contact:***

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"The art of letting go: Middle- and back-office right-sourcing options for insurance investment management." PwC FS Viewpoint, March 2014, www.pwc.com/fsi.



DC-14-0107

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