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Outsourcing Long-Term-Care Administration

Track: Long-Term Care

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Recorder: DAWN E. HELWIG

Summary: Many long-term-care insurers are outsourcing administrative functions to management organizations. The panelists discuss the reasons for this outsourcing and a number of important business issues. The panel focuses on outsourcing pieces of administration, as opposed to outsourcing the entire administrative function.

Ms. Dawn E. Helwig: I am very proud today to state that I have put together a panel of predominantly non-actuaries. However, one of them couldn't be here. I'm going to take over for him, so you're going to end up with only 50% non-actuaries on the panel. This panel is discussing the variety of services that could be outsourced in long-term-care (LTC) insurance. We're trying to concentrate primarily on outsourcing particular pieces of services rather than outsourcing the entire TPA function. Our first speaker is going to be Ron Hagen from Northwestern Mutual (NML). Ron is going to give a little background for us as to why a company that is as large as NML might decide to outsource any of its LTC functions.

Ron's background is quite varied. He worked on Capitol Hill for awhile as a lobbyist for the American Association of Retired Persons, doing a fair amount of work on both Medicare Supplement and LTC. He also chaired the first NAIC Long-Term-Care Advisory Committee. He then worked for WellPoint and then Fortis and has ended up at NML managing their new LTC division. He's one of our distinguished non-actuarial presenters.

The second person who's going to be talking to us is Don Charsky, who is an actuary. Don is president of LifePlans, which provides LTC outsourcing services to more than 60 LTC insurance companies. Probably many of you are aware of LifePlans from all of the industry surveys that they have done, which I know I've quoted from extensively. These surveys have been very helpful and informative in

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providing information on who buys LTC, what long-term claimants tend to look like, etc. Don is going to talk to us about the different types of LTC administrative functions that can be outsourced.

Our third speaker was supposed to be Gary Jacobs, who, unfortunately wasn't able to attend. Gary was going to talk to us about how to get your outsourcee (the company that you're outsourcing to) financially involved for the results of what it's doing. This is a critical concept because as I'm sure everybody who's ever thought about outsourcing any function has considered, there is very definitely the possibility of it being a little bit like "letting the fox into the henhouse." You don't want to reward them for doing the wrong things, and Gary — through me, in this case — is going to talk about how to financially motivate the administrator to do the right things. Gary is with Capitated Health Care Services, which is a group that is probably one of the premier providers of care-plan management and managed care services for LTC.

Our fourth and final speaker is Peter Goldstein, who's the senior vice president at the Long-Term Care Group. Peter is responsible for the company's business development, and is a non-actuary. The Long-Term Care Group provides services to 17 insurance companies and administers more than 350,000 LTC policies. Peter's going to be talking to us about how to effectively evaluate the services that your outsourcee is providing to you, i.e., not how to financially incent it, but how to determine whether it is doing a good job.

Mr. Ron Hagen: I'm going to focus on what some of our thinking was at NML. We just got into this business 18 months to 2 years ago, through a separate stock subsidiary company called Northwestern Long-Term Care Insurance Company. I'm going to give you some insights from our perspective as to how we thought through the issue of outsourcing—certain critical administrative and other functions of the program—and I'm going to spend a little time going through the types of functions that we ultimately did decide to outsource.

I think it's important to understand that I'm not intending to provide advice to anybody or counsel anybody on any particular pathway to follow in making these kinds of decisions. We're a unique kind of culture and company as it exists today, and our way of looking at these things is predicated on a number of very important factors from our perspective. I think we all have to come to this with our own priorities in mind, and ours aren't necessarily going to be the same as yours as you think through some of these issues.

We do come to it with an obvious passion for managing expenses and costs. We come to it from a very conservative type of perspective. LTC is the first new core product for NML in almost 30 years, since we entered into the disability business, it is a very important product line for the company. We had to think a little bit outside the box for us, which is a somewhat relative statement to make for this industry at this point in time. But, if we're willing to put more than our big toe in the water on this kind of front with the kinds of due diligence we did, it probably should give you some hope that some of you can make these kinds of decisions and manage the risk in outsourcing the variety of functions we're going to talk about.

I'm going to focus on insurers that are already in this marketplace, rather than looking at it from somebody coming into this anew. We certainly have choices when we look at the variety of services and functions that are critical to successfully starting up an operation like this. We have choices as to whether we're going to be looking at outsourcing the entire operation, certain key administrative functions, or sales and marketing—a whole variety of different things that are critical to successfully launching a program like this.

We'll also try to address the issue of whether it is more risky to outsource all, or just part, of this operation. Part of that, as you'll learn, from the comments that I'm going to make, is dependent on the type of partnership relationships you have, as well as the general core competencies of the outsourcing partner that you're going to work with, as well as the due diligence that you do in advance in looking at what's really important to you as a company. What's important or critical to us may not always fall in place as being critically important to you. We think there's a lot of overlap.

There are some key things to look at when we think about what kinds of administrative functionality that we can outsource to a partner. We'll talk about which of these we've decided to keep in-house and which we decided to outsource, but I think we run everything in the gamut from product development and pricing of the product to sales management and marketing.

I think that many of you probably understand that we are an exclusive career shop at NML. The only way agents can sell our products and services is by being a career agent for NML. We have a very demanding group of agents. These agents are not necessarily abusive, but they are very direct, very knowledgeable about the products that they're selling, and they're very demanding in the kind of service that they get for themselves and their policyowners. Everything we looked at in the process of making these decisions was through the prism of the policyowner, and what's in the policyowner's best interest.

One thing I came to discover very quickly at NML is that when we carve something in stone on a wall in the home office, they're not just words, they represent things we actually live and breathe by. This is a very important element. We make sure that we get the customer service piece right, and that we audit and monitor on a regular basis that customer service performance and those performance standards.

Obviously, from a risk-management perspective, claims administration is another very important thing. We have very few claims at this point, being so new to the business, but claims management is something we're paying a lot of attention to as we develop a partnership with our TPA. We've developed both our underwriting standards and our claims administration standards in the home office.

Maybe the obvious question is: why would a large life insurer like NML, with no history and background, which has never outsourced any kind of administrative functions, come to the conclusion that with this, as a new core product that we have already invested mightily in and will continue to invest mightily in over time, chose to outsource any portion of what we're doing here—either administratively or on the risk management or sales and marketing side?

Let me just tell you, again, where we come from on this. We're a very conservative company. We have a tradition of not outsourcing any of these types of administrative functions. We considered this very long and very hard. We had the advantage, in the case of the Long-Term Care Group, with having done some due diligence, and having really become knowledgeable about the organization through an investment we had made in the organization off-line—separate from any decision we made to contract with them as administrator for any portion of what we were going to do.

As with a lot of companies like NML, probably, we have a passion for control. We don't like to be surprised about anything. We're very conservative, but we also put a very high premium on compliance. So we wanted somebody who had some demonstrated capabilities on the regulatory compliance front, and had something to bring to the table to work with our in-house people on that score. We wanted someone with whom we could really fashion a comprehensive partnership who had outside knowledge in the core risk-management elements—underwriting, claims management, and care management.

Again, I would probably be remiss if I didn't tell you that we have internal conversations on a fairly regular basis about whether in the distant future, we would ever consider bringing this back in-house. We, at this point in time, have no plans on that, but there is a culture that exists in our company, as you can see by the fact that this is the first time we went in this direction—that really says for control and other reasons (quality perhaps) over time, that this is an investment that we will want to make at some point. Not near-term, certainly, but it is something that in a contingency planning mode we're always considering and talking about. It's the culture; it's the nature of who we are at this point.

We're also, importantly again, a mutual company, and as I said, everything is looked at through the prism of the policyowner. We have a very strong penchant for audit and accountability and performance standards, and making sure that we constantly audit those performance standards. And we must have a partner who feels comfortable with that relationship. We also place a very high premium on expense and expense management in all of our core businesses such as disability insurance and LTC. So, that was an important part of this as well.

Again, we were helped out by the fact that we really had engaged in some significant amount of due diligence earlier on, and followed that with a great deal of discussion back and forth with the Long-Term Care Group, in this case, about their competencies and what they brought to the table and how we would manage this process. I think that's important. It's important to have not only a competent partner, but a partner you can build trust with over time, and that can provide you with the kind of support that we're talking about.

If we look at the types of things we could outsource, very clearly we felt that we needed to stay in charge of all of our sales management elements, including the payment of commissions, licensing, training, marketing support, and sales-force management in general. It's a key part of who we are. We believe we are the preeminent needs-based salesforce in the country. We are continually recognized as such. That's something we wanted to maintain complete and total control over. That also holds for product design and pricing. While we certainly draw in the experts from our partner, in this case, this is something that we have continued to assume. We were very unwilling to outsource any elements on that score. Advertising and promotion, compliance, and best practices are all things that we really felt we needed to keep our hands on on a regular basis.

We looked at some other things. We looked at our internal systems capabilities, or lack thereof. With a new product line like this, we really didn't have much. We would have had to have gone out and hurriedly spent quite a bit of capital and resources to develop those systems internally. NML has some very high standards as to how we look at these things. It would have taken, we believe, a considerable period of time to develop the administrative systems, the billing systems, the policyowner services, and the agency services systems to make all of that happen. We were already in a process, as probably many of you can appreciate, of having spent a number of years looking at whether we were going to get into this marketplace or partner with some other insurer. Having decided that we were going to do this and assume the risk for doing this ourselves, we frankly felt some desire and urgency, given who our agents were and their desire to get this product out to their policyowners. We have a large target market in that age range of people who are typically buying the product today. We really felt it was important that we not spend the next four or five years developing those systems before we went to market.

Underwriting was something that we developed with the able help and assistance of our partner who had a considerable amount of experience in developing the necessary kind of risk and underwriting standards. Our joint medical staffs and some of our more experienced in-house underwriters spent a lot of time sitting around the table trying to figure out what we wanted to do here. They have since spent a lot of time revising and modifying those underwriting standards. We want the final say over that, and we've maintained that even though, clearly, our TPA is the individual entity that underwrites to those standards—all of our coverage, medical records, the whole enchilada, if you will.

With clear accountability and performance standards in mind, we have also outsourced the claims administration function. We've developed those standards in partnership with our TPA. We're just starting to implement those standards on the first claims that we're getting in the door. We feel really comfortable about the relationship we've developed. Sharing information, respective medical staffs, and looking at those underwriting standards and how it stacks up at claim time when we start to pay claims are critical. We have put, as probably most companies do, a very high premium on making the claims administration process as easy and trouble-free as possible for our insureds because that's what they're used to. That's what our agents are used to. If you start having problems there, then we're going to have problems in many other areas, too. And I think that sense of urgency and importance is shared by our partner.

If you look at the strategic business issues and decisions that you have to make as an LTC insurer, one of the things that comes first and foremost is the commitment you bring to the market. Is this a short-term deal? Is this something you firmly believe you both will be committed to for the long term, and are willing to invest in? Clearly, NML is willing to invest. Clearly, we're looking for that kind of long-term vision on the part of the partner. That was an important consideration for us, along with their existing capabilities and competencies.

Our desire for control over critical functions was very clear from the beginning. If we're on the risk, we want control over those critical risk-management functions—underwriting and claims administration. Also, were we going to be facing a business partner and partnering with somebody who was going to be a part of our whole overall strategic and business planning process? We wanted that. We ultimately wanted to have the final say, but we wanted to have somebody who could add something to that process and was experienced in the business. That was an important consideration for us, as was comfort level. We can talk about how we go about making these decisions to outsource any of this, and how you make a decision on whom you're going to work with. We didn't want to micromanage the operation of the TPA, but we really wanted to have a clear understanding that there was a comfort level, and that we were up-front with each other, and shared issues before they became problematical at the back end. That communication process cannot be understated; the importance of it is absolutely critical.

Let me conclude real quickly here. We all have to make individual decisions about what our tolerance is for customer service, billing, administrative, and policy-owner service risk. Timing was an absolute key and a central factor for us. We felt we maintained control over the critical risk-management issues. We had a partner that could provide for our policyowners and our agents (because they were our first customers that we had to sell on this program) and for the quality of the program, and how it was going to perform over time. We wanted a partner that had a similar commitment, understanding, and capability. Because this was going to be a new core product for NML, we certainly didn't want to fall on our face by having administrative problems become bigger. We needed to have a commitment to invest in the business long-term. That commitment was shared with our partner. We needed a partner relationship, not a vendor relationship. We had to have that same commitment and philosophy working on the other side. We continue to invest many millions of dollars a year in the development of this business. We're committed to it long-term. and we wanted to see that same philosophical commitment on the part of the partners that we talked to.

There are other issues surrounding the equity interest—if you will, the investment we're making in systems and other things to make all of this happen. I think we have an open dialogue, and we will continue to share information. Having consensus, making joint decisions, and maintaining a strategic business planning process is a critical part for us in moving forward.

So, with that I'm going turn the discussion over to Don.

Mr. Donald M. Charsky: You'll notice some overlap between the various presentations, and I think that's the nature of the beast. It would be impossible for Ron to talk about his decision for his company, in terms of what it did and didn't do concerning outsourcing, without dealing with all the different issues that I also will be getting into as I discuss an overview of all the different options for insurers to consider.

As Dawn mentioned during the introduction, LifePlans works with about 65 different insurance companies. We've been working with insurance companies for more than 13 years. When last I counted we had 28 different products or services that we provide to insurance companies. So perhaps the most important aspect of how we interact with insurers and how insurers interact with us is this partnership. It is a dynamic partnership, and we'll talk about that at the end, concerning an evolution both in the insurer, and their ability and their needs, and our evolution as a company in terms of meeting those needs, etc.

LTC is still considered an experimental coverage. All of us who have been in the industry for many years still consider the industry as experimental because we don't know all the answers yet, and we probably don't even have all the questions yet that we should be asking. As a result, it's a very dynamic situation. The outsourcing options available today are different from the ones available three months ago and the ones that will probably be available six months from now.

I look at the outsourcing options from three different levels: strategic, operational, and ultimately tactical. It's easy to find any one of a number of people who can help you with product design and pricing. There are plenty of people to file the forms and seek the approvals at the regulatory level. Marketing, advertising and promotion, and lead generation in response fulfillment can also be outsourced.

One of the more complicated aspects of dealing with outsourcing from the insurer perspective is that there are just so many options and so many packages of options available. A number of companies have complained to me that my group, Peter's group, and similar groups have actually made their jobs more difficult because we challenged them to figure out what it is they could do, should do, and would be able to do, and be happy to do both today and in the future to have an effective partnership today and in the future that would meet both party's needs.

Ron mentioned how sales, sales-force management, licensing, compensation, and underwriting are critical. This is actually the area that gave birth to LifePlans. It was primarily the first area that we offered products and services in. Of all things, our first service was an outsource capability to do assessments in the field for people when they applied for insurance. We now do more than 10,000 assessments a month. We probably do 85% of what's done in the U.S. on behalf of insurers in face-to-face evaluations when people apply for LTC insurance. But there are also strategies in operational areas associated with underwriting. Ron mentioned policy development. Issues here include: decisions, and ultimately appeals in related activities associated with those decisions; policy administration, issuing policies and following up with changes, riders, etc.; premium invoicing, remittance, and reporting on in-force and all the related data administration.

Going to the important area that Ron suggested—claims. Again, we have this strategic policy development. What should one do, and how should one do it? Then we get into all the operational and tactical activities: requirements, decisions, appeals, and finally the ultimate claims payment and record-keeping activities, as well as financial reporting, experience exhibits, gain/loss, i.e., things that were talked about in the Valuation and Financial Reporting of Long-Term Care (Session 22PD).

I would suggest that there are numerous possibilities associated with an insurance company and how it can get these services both individually and collectively. Think again that there are three levels to deal with. In my opinion, LTC is interesting because we have had so many outsourcing options. When I look at other lines of business I don't see that there are that many outsourcing options. One important example that someone mentioned to me a little while ago, and I wanted to make sure I included, is the outsourcing option of other insurance companies providing certain services. We have, in LTC, a number of insurers which, as an alternative distribution strategy, make available their products and services to other insurers. I find that very interesting, given the relative newness of the market and its inexperience, because in many other lines of business it seems we didn't really experience that until markets were more mature and developed.

Strategic examples are product design and pricing, and underwriting and claims policy development. An operational example of what I'd consider true outsourcing is sales-force management. A lot of companies employ managing general agents where they basically give them the product and say "here you go, good luck. Please send the apps in." That is similar for turnkey administration, TPAs, and any other full-function delegation.

Tactical examples include what I'd consider as hiring help. A great example is filing and compliance, or again, those underwriting or claims requirements that I talked about earlier. I think that's the bigger difference frankly.

A key considerations is that it is always a partnership between the insurer and the service provider, and everybody has to be on the same page in terms of expectations. There are just so many quality options available that I think it's a challenge for senior management in insurance companies to always be evaluating themselves, their competencies, and the cost-effectiveness and quality of their services and products in such a way that they can also consider all these other options.

I did a strategic study when I worked for UNUM and helped them figure out their plan for getting into the LTC insurance market back in the mid-1980s. At that time we looked at the various outsourcing options, and there were almost none, so the strategic plan was essentially, how do you build the system and put the people in place? and how do you get the capacity in place within the company to make a go of it? Now for a company getting into the business 10 or 15 years later, there are just a multitude of options. And I would suggest that for a company getting into the market today, the majority of the effort involved is to look at all the options in terms of service providers and people who can help you enter the market on a basis that you are comfortable with, and help you learn from all the other player's experience and mistakes, etc.

It is a challenge for some companies. Ron discussed some of the challenges NML had with delegating responsibility. Peter assures me that Long-Term Care Group isn't really micromanaging. It's really serious planning, and it takes extensive negotiation and very detailed-level negotiation, right down to time standards, performance, etc. There has to be a clear standard of accountability; it's very important that everybody understands how they're being evaluated. You also need to consider the future of the insurer and its changing needs and resources.

There are many ways of packaging services. Some services are available on a stand-alone basis. Some are part of a very large and expensive package. Some service providers are specialists in one area. Others are more generalists and take on the various roles and functions.

Ms. Helwig: What Gary was going to talk about is, how do you get your outsourcee, i.e., the person that you're outsourcing to, to do the right thing? What kind of financial incentives can you provide in order to get them to look out for your best interests?

In getting the financial incentives aligned correctly, you may have somebody who's doing one or two on the list of outsourcing items rather than doing the whole list. If you're not reimbursing them appropriately for that particular outsourcing item, you really could be encouraging them to do the wrong thing. Alternatively, you could be penalizing them for something that they really have no control over.

For example, if you went to Gary and said, "We want you to do all of our assessments, and to provide all of our plans of care, and we're going to pay you on a totally capitated basis," it wouldn't be very fair because Gary's not doing the underwriting and he's not really going to have the opportunity to determine what kind of risk you're putting on the book for him. So you have to make sure that you're reimbursing the administrator in a way that's going to be fair and is going to be appropriate for what it is doing for you.

On the underwriting side, the administrator could be doing any one of a number of functions, including telephone interviews, face-to-face interviews, getting and evaluating attending physician's statements, doing risk stratification (determining whether somebody should fall into preferred, standard, or substandard), etc. Probably the most difficult area of all of them is doing the cognitive testing. That's the area that has been shown to have the highest incidence of early claims in LTC policies. To quote a LifePlans study, I believe it is the number one area of early claims for insurers. It's also probably most difficult in many ways to incent for someone who is going to do that function for you.

Gary wouldn't have done this, but I'm going to throw in one little actuarial thing here. If you look at the costs of LTC claims as being the product of three different things—the frequency of claim incurrals, the average length of that claim, and last, either the mix of services, or the average charge per day that you're getting for that claim—the underwriting predominately affects that first thing, the frequency. To a certain extent, it might affect the length of claim as you may get a different mix of healthy versus unhealthy people in the underwriting process. In order to pay someone appropriately for doing that function properly, you, to a certain extent, need to get them on hook for that risk. And that is really difficult to do unless the entity you're outsourcing to has a different type of license than a normal TPA license.

Gary has suggested that volume discounts could be provided, where basically the outsourcee is giving you a discount if they're providing or doing all of your underwriting for you. I would suggest that there is the possibility that this could encourage the person you're outsourcing to speed up the underwriting process, perhaps by not getting all the tools that they want in order to try to get a timely turnaround and quick decision made. Volume discounts may be a great negotiating tool, but they may not ultimately incent the person in the right way. A monthly retainer might be a better way of doing it, where you basically make an assumed distribution of the types of tools that would be used and then do a true-up at the end of the year.

Having the vendor involved in doing some reinsurance, or having some sort of incentive arrangement tied to the actual frequency of claims, are the best ways of getting them financially involved. But again, there needs to be some sort of different licensure that the TPA is going to have to have. They're going to need to have a separate reinsurance company, or something to put that risk through. A TPA is not, in and of itself, allowed to take on risk.

On the administrative side, as has been talked about, there are a number of different things that could be outsourced. The vendor is going to have to be a licensed TPA to do these things, and if they're a licensed TPA, there really can't be any financial inducement to them in order to impact claims. So, you're basically going to be paying them for their services on either a fee-for-service basis or on a percentage-of-premium basis. How that fee structure is set up could possibly have some incentives one way or another to the vendor, depending upon whether you're putting more of it up-front in the first-year costs, and less of it in the renewal-years cost.

There's probably a fairly good reason to try to incent the vendor or the TPA to do more on the renewal end, such as getting a nurse involved in some customer service work, that might be a little bit more expensive, but might save claims in the long run. If you have your TPA fee structure too much skewed to the first-year cost, you might be doing yourself a disservice in that regard. You could also introduce some sort of productivity incentives.

On the claims administration side, again, there's a wide variety of services that could be provided. Here you're really trying to encourage the vendor to affect two different areas: the length of stay and the mix of the services. That could be done in a couple of ways. You could actually reimburse the TPA by paying them a fixed amount per day; that will encourage them to modify the care so that it's more on an outpatient basis and to use community services as much as possible. I think this is what Gary was getting at as he refers to bundled service packages. Or you can pay them on a traditional fee-for-service basis—for example, pay them so much for actually producing a plan of care.

You can go the full capitation model here as well, and, again, a TPA would have to be licensed a little bit differently to do this. You could pay the TPA a fixed amount per insured. I would suggest that if you do that completely, and the only thing that the TPA is doing is the care management function — i.e., they're not responsible for the underwriting as well — then that can be very risky for the TPA. Rather than doing a fully capitated basis, you could have some sort of risk-sharing arrangement or incentive arrangement where you're comparing actual-to-expected loss ratios. Or the TPA could set up a reinsurance company that is taking part of the risk, which, again, would incent them to do the right thing.

Capitated Health Care Services is very interested and very adamant about really wanting to move the care management function up to the customer service area. In other words, by starting to get a nurse involved very early on, in looking at a person's condition and identifying emerging care needs immediately. At the time a person comes with a claim, the appropriate level of care can be determined, and how urgent the care is, taking advantage of community referral resources and coordinating all the primary payers. The end result of that is that the clinical outcomes are greatly improved.

I'm kind of guessing here, but I think what Gary is getting at is that if you want to incent the vendor for greatly clinicizing customer service, you'll be looking for a vendor that will have some networks of providers available, that will have the ability at the customer service level to redirect non-eligible policyholders to community services, and that will have some immediate access to care resources if triggers are met—and if they're not, to the community resources.

In order to get a vendor to do this, again, you can pay on a fee-for-service basis, but you'd really probably want to be incenting them with a greater payment for things you want them to do. You could have either a direct payment for having a nurse involved every time a person calls in, or at least a greater payment on the renewal side, paying more per dollar, per policy, or per dollar of premium renewal than what you might otherwise.

In summation, I think Gary would have said that you want to encourage your vendor to make very efficient use of the available community services. Hopefully you'll have your payments to a vendor set up so that they are flexible and that they encourage what he calls internal competencies by incenting them or encouraging them to do the things that you have actually asked them to do.

Mr. Peter M. Goldstein: I think just about everything about outsourcing has already been said, so I'm not quite sure what I'm going to talk about. I'm not going to talk about the different things you can outsource. We know that now. What Dawn asked me to talk about is how you evaluate if this thing is working. What are some of the things that you need to be aware of before you can make an outsourcing decision? How can you overcome the natural biases of thinking our way is the only way? We see a lot of insurance companies that may have been writing life insurance for 200 years, and don't know anything about LTC. Yes, hopefully they get some individuals who know what they're doing. But there's a real prejudice in a large insurance company that this is how we've done it for 50 years, and that's how we want to do it. So you need to be aware of that yourself as you go down this path. Maybe you don't have to do it that way, or even, why do you do it that way? Has anybody ever asked that in their own company? The answers you get are amazing.

The other thing is—and Ron hit on this, so I'm not going to talk about it— is that companies are afraid to lose control. "We're not going to give the risk management to somebody else, we're on the hook. We're going to let someone else talk to our agents. What are they going to say?" There's a real control thing, and if you structure the arrangement properly, you can do this and still maintain control.

Last, there can be an internal conflict of interest. It's not unusual for people to be cast with going out to evaluate an outsourcing situation, and those people may perceive that as a risk to their own jobs. It's interesting, but you don't necessarily see it with line-level people. They usually are open-minded and are just trying to do an evaluation. But when you get to the manager, and he or she starts thinking, "I've got 97 people reporting to me. What's this going to mean? Am I going to lose my clout? Are they going to eliminate my department?" These are real concerns that people within your organizations have, and you have to be aware of that natural bias because the information you get back in evaluating whether something like this makes sense may not be spun the right way.

Let's talk quickly about some of the criteria that you might want to consider in selecting a partner. First of all, can they provide the services to meet your needs? You obviously need to know what your needs are. Ron talked about going through an analysis of what you do and what you don't want to do. So you need to evaluate whether those services can be provided.

The financial viability of potential partners is a concern. You're a large insurance company, and you have financial ratings. A lot of the outsourcing companies are smaller companies—potentially start-up companies. Are they going to be able to support you if your business takes off? Do they have the wherewithal to grow with you? Are they willing to make the commitment of dollars necessary to serve a large national organization?

Today you can't say enough about technology, and I think that the ability to keep up with technology is probably one of the biggest pains that the largest insurance companies feel. So, if you're going to outsource the business and you're trying to avoid dealing with your own internal pain—building new systems, modifying systems—then you want to certainly make sure that the company you're going to give the business to can support the technology in a go-forward way.

The management philosophy is very important. Are you aligned philosophically with your partner? Do you see the business the same way? Do you see growth the same way? Do you see opportunity the same way, and is there a commonality of culture between the people who are going to have to be dealing with each other in a very close way?

Last, as we talk about trying to tie this thing together, is the outsourcing partner prepared to assume risk, in whatever form it may take? Is it willing to put it on the line and truly get in the game with you?

Now outsourcers are people, too. We actually have needs that we need to consider before we jump into bed with a big insurance company. One of the big considerations, and I think Don would probably share this with me, is the degree of commitment of the company to the product. The outsourcee, regardless of which functions you will outsource, is typically going to spend a lot of money to prepare the business for you. It is going to set things up by acquiring resources and hiring people. So, what's your commitment to the product? Is the company really behind it from a corporate management level? Or is this some little side project off in the corner that nobody really knows about, and it just hopes it goes well? Is the company willing to spend money to show its commitment? Is it willing to invest? Is it willing to pay start-up fees? Does it have a plan around how it's going to grow this business over the long term? Because one thing we know is that LTC is not an overnight success.

How about the pricing? What happens if you set up this whole thing, but the pricing is not competitive? There are no sales, and the services that someone's going to provide never get used. That's very costly. What's the distribution strategy? That's something we want to understand. How are you going to sell this product? Who's going to sell it? What's the internal support behind the sales? We know that LTC needs to be sold. You can't just throw it out there. It requires corporate resources, training, support, and motivation. The people who are successful in the business know that.

A critical success factor to making one of these relationships work is the partner-versus-vendor concept. You're talking about getting into an arrangement where your partner is performing functions that are completely integrated into your operation. You can't go into it thinking that it's just a vendor and it is providing some sort of a throwaway service, and we're gonna grind 'em down, get the best deal, and just totally micromanage the thing. It won't work that way. So, you have to go into it with a partnership mentality. Win-win is the most overused cliché, but anything that's good for the insurer and not good for the vendor, or vice versa will not be good for the relationship.

Another thing that's critically important is a communication plan. You must have accountability. You're dealing typically with a large organization, which has many moving parts. You may be dealing with underwriting, or you may be dealing with claims. Those two departments within the company may not be talking to each other. You're going to be dealing with management. You're going to be dealing with distribution. Who is responsible for coordinating the communication? Who's accountable for what? Where is the leadership? It sounds simple, but if you have a distribution system that's run by a big marketer, and you have the company and an outsourcing partner or two, just keeping and managing that communication is a full-time job for probably more than one person. So, I think that's critical to success.

Now the bad news, which "Gary" touched on, is that it would be really nice if you could set up one of these deals so that if the deal makes money, the company makes money—then we can tie everybody in. We can share the profits; that way you really align the incentives. But, of course, you can't be compensated based on profitability. The regulators would not like the idea of giving a vendor a piece of the claims savings. That would be terrific. We do such a great job underwriting and in care management, you price the thing for a 15% ROI, but we're actually hitting 25%. So, we'll just whack it up. It doesn't work that way. You have to find other ways to tie the two companies together, and monitor the performance.

What I want to share with you are some of the ways you can monitor performance. Time service is one type of performance that you can monitor. Standards might include: attempt a phone interview within three days; request an APS within five days of receiving a completed application; issue 100% of the policies within three days of making an underwriting decision; process 95% of the benefit eligibilities within 10 business days. These things can be tracked and reported on, and they will give you that sense of control because you know what's going on even though it's not happening right down the hall.

There's another type of performance standard: response time. This is critical in the areas where you're touching outside people—agents and policyholders. Examples include: answer 90% of the calls within 30 seconds; respond to inquiries from insurance departments or policyholders within seven days; respond to complaints within ten days. Again, these are things that can be monitored and reported on.

There are other measures of performance standards. In underwriting you can perform audits to look at quality and consistency and whether they are following guidelines. Other measures include billing (there are all kinds of time and response issues around billing), sales (if you're outsourcing sales, sales reports), and then reporting. Are you getting the reports? Are the reports telling you what you want? Given that we have a backdrop of people wanting to have control and wanting to know what the business is doing, the type of reporting that is provided by the partner to the insurance company is very important. It's really a key factor. It should be part of your evaluation process. What kind of reporting am I going to get? Are the reports useful to me? Are they timely? Can I get them on-line? How do I manage this flow of information so that we know how we're managing the business? It lets you monitor the business so that you can see how it's going, if the experience is good. Are the policies getting issued on time? Again, it plays into that sense of control that the carrier needs to have.

Now there are other ways to align interests. One of the keys—and Don and I do not want this coming back to us when we start negotiating—is performance-based compensation. You can't pay people based on saving money or having profitability, but you can set up standards and then reward the partner for meeting the standards, or conversely, penalizing them for not. You can set up a whole set of performance standards, such as some of the ones I mentioned. Have a set of base fees, but if the performance exceeds those standards, you can pay a bonus. And that bonus could actually be passed down to the employees of the partner who is working on your business. So you can tie everybody all the way through the organization down to the people who are inputting the applications. On the other hand, if performance continually falls outside of stated goals, maybe the administrator is willing to put some of the fees on the line, and take a reduction in fees, or have a holdback in fees that will be paid when standards are met.

From the outsourcer's side, we may want to talk to you about minimum guarantees, because it takes the same amount of time and effort to set things up to do a service for 10 policies as it does for 10,000. What are you willing to put on the line in terms of committing to the business and allowing some of these smaller companies to gear up and staff up to provide the services for you and make sure that they at least get their minimum costs covered? We don't want to be benefiting or losing by things that are outside of our control, such as the number of policies that you sell.

Another way to align interests is risk sharing. What I'm going to focus on here is sharing the risk in a reinsurance kind of a way. Typically, this would really apply where you're outsourcing underwriting and/or claims. The form of reinsurance that is typically used is a retrocession. Why a retrocession? From the Long-Term Care Group perspective, our balance sheet—as pristine as it may be—would probably not get your corporate actuaries excited about having Long-Term Care Group on the asset side of your balance sheet. Instead, you could coinsure part of it out to a big reinsurer that you would feel comfortable ceding risk to, then we could structure it as a retrocession behind them. The administrator is still on the risk, but they're not tied directly to the insurers. What reinsurance does is two things. Number one, it puts the partner's skin in the game. Now you're not just a fee-driven entity that gets paid $100 for every policy we issue—good, bad, or indifferent—so let's just issue lots of policies. When the company's actually putting their balance sheet at risk, that really aligns interest. Second, it's really a benefit to the outsourcer because, if in fact the product produces better-than-expected results, then you're at the same place as the insurance company. You do get those excess profits, but just not as an incentive-based compensation.

The ultimate measure, of course, of whether something like this is working is customer service. As an internal consideration, are the people who are dealing with the business happy? Do they like the relationship? Are their needs being met? Of course, you also have the external policyholders and agents. My experience with agents is that if they're not getting what they need, they let you know about it. They have a financial interest in what happens with that policy, and they're watching it very closely. You will know, very quickly, if you have a problem with your outsourcer, based on your agents.

So, customer service is the ultimate measure. Is it a positive experience? Does the partner meet the needs? Are they growing with the business? You can't underestimate relationship management. We are all in a relationship business, and to the extent that you manage those relationships you control how things flow back and forth. If you work with your partners to both achieve the same goal, then it's much more likely that you'll have a positive outcome.

Last, outsourcing is here to stay, even for companies like NML that never outsourced anything for 100 years. There's a convergence of trends right now in the marketplace. First of all, there's the growth of the LTC product. The people who have been in the business for a long time are getting so many opportunities thrown at them that they don't know how to handle them all. No one wants to turn away new business, so rather than turn it away they fight the management of big companies who maybe don't care so much about LTC as opposed to life or some of their more core products. The fact that the business keeps growing means you're going to go to places to off-load some of these things so you can do more deals and grow your business.

I think demutualization is a wake-up call for everybody—to have analysts in your office every 90 days looking at expenses, revenue growth, and profits. It's a whole different focus than the insurance industry has really had to deal with for the last 100 years. As you know, looking at analyses and reading the reports, and watching the stock market go up and down, the drivers are revenue, profits, and expenses. The expenses were kind of buried in a mutual company, but in a public company they're right out in-front, and one way to handle expenses is to outsource.

I subscribe to *Upside Today*, a technology newsletter, and I thought this was really interesting: "As the tech giants attempt to keep costs down and revenues up, outsourcing has become more and more popular. Companies like Nortel, Lucent, and king of the networking hill, Cisco, are taking manufacturing, administration, and all manner of traditional functions to outside contractors." That's what the tech companies are doing.

Now we know that the insurance industry is not quite as advanced as the tech companies. But if Lucent is the biggest manufacturer of telephone equipment in the world, and they are outsourcing manufacturing, doesn't that mean that we should all look within our organizations and identify what is it that we really want to do? What are the core competencies that we bring to the table? Is billing something that we need to do to run our business? Or could someone do it better? That plays into the technology. It's hard to keep technology up-to-date in a huge, multiline insurance company because there are different needs from all the different areas and departments. Y2K put such a crimp on resources that stuff was mortgaged and put off and initiatives were not done, so now everybody's playing catch-up and trying to get ahead of the curve. Outsourcing is going to play a huge role there.

LTC, is such a unique product. It's so different from everything else. As Don said, when he started there were no outsourcing companies and now you can outsource everything. Focused expertise and outsourcing will continue.

Finally, business is becoming much more customer-driven. Look at what the banking industry did in creating ATMs so you could get a more direct experience. If you read any of the futurist books, any of the things about what's going to happen in the next millennium, everything starts at the customer and then moves back. I think a lot of large organizations are set up the other way. That's how we do it, and let the customer be. But that's going to change a lot, especially with the Internet, getting things on-line, having all this information at your fingertips. So as you focus on being more customer-driven, I think it's going to lead you to looking at companies that can provide specific functions.