

Risk Transfer and Outsourcing

Cologne, the 16th of May 2013

Agenda

→ Starting out with Outsourcing

Requirements with regard to Outsourcing

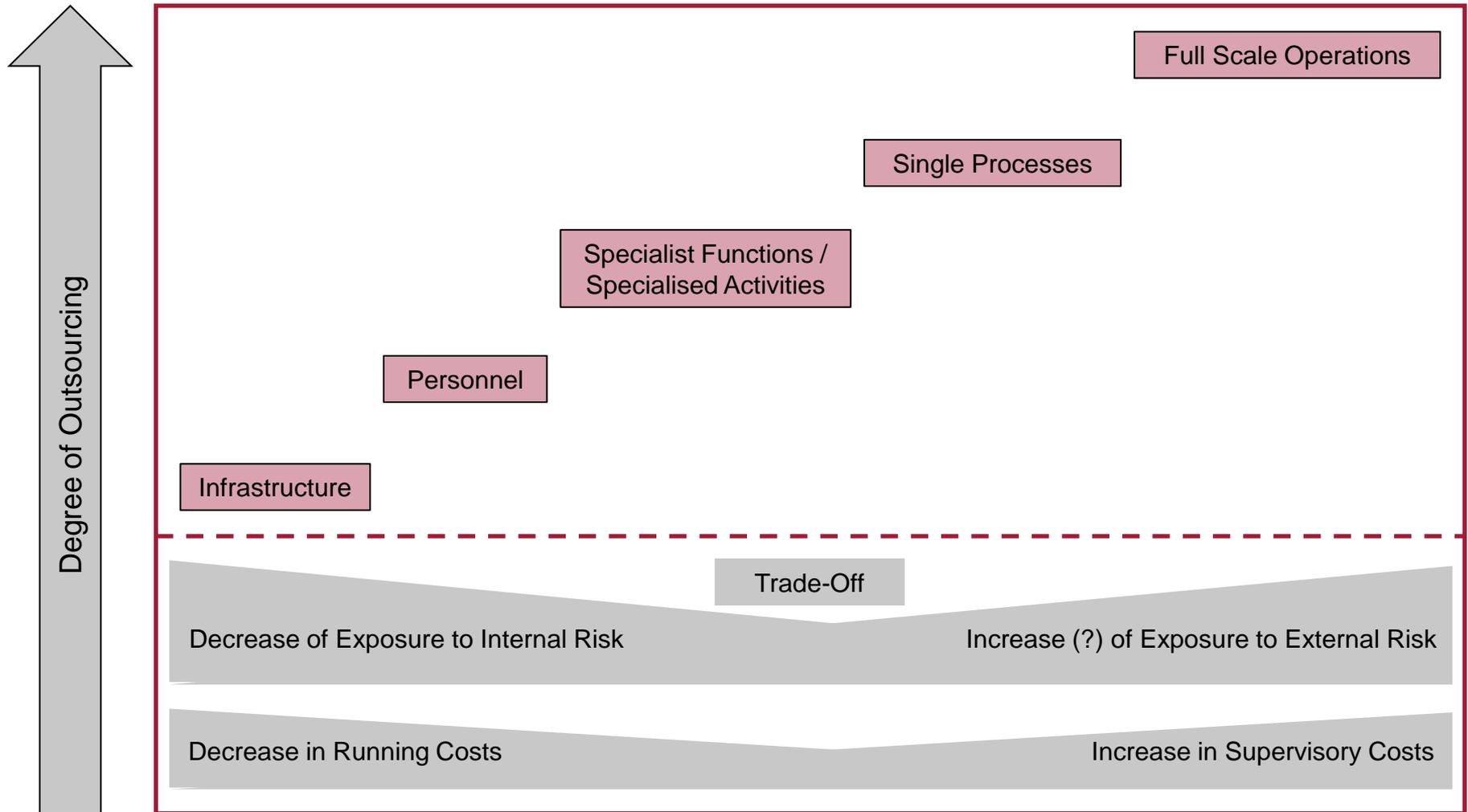
Roles and Processes

Risk Analysis and Dealing with its Consequences

Conclusion

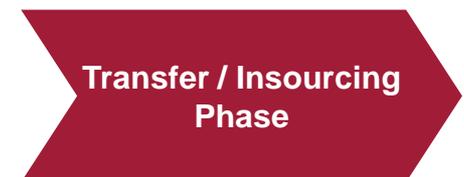


Degrees / types of Outsourcing



Expectations connected with / reasons to opt for Outsourcing

- Increased cost effectiveness / cost reduction via decreased „Total Cost of Ownership“!
- Reliability with regard to fulfilment of regulatory requirements / legal obligations!
- Better performance / higher quality of services (i.e. somebody else can do it better)!
- Lack / availability of scarce internal resources (know-how / qualified employees)!
- Flexibility / economies of scale in the use of resources to meet e.g. Business Continuity Management requirements!
- Clear cap on IT-costs / calculation of IT-costs!
- Concentration on own core-competencies!
- Flexibility with regard to changes in the business model / business!
- Clearly defined contact persons!
- Prolonged life-cycles for the currently installed clients!
- Increase in productivity!
- Optimal scalability of resources being used!
- Decrease in capital lockup via mutation of fixed to variable costs!
- No own investments (software, hardware, new technologies)!
- ...



Possible risks incurred in connection with Outsourcing (I / III)

- No objective calculation of the Business Case taking into consideration costs
 - costs of transfer of the operations to the service provider
 - running costs of the services
 - costs of the retained organisation (incl. costs of the on-going supervision)
 - costs for the reintegration / transfer of the operations
- Loss of close contact to the customers / the front line
- Deficient selection process (e.g. non-adherence to selection criteria based on quality / reliability of service, deficiencies become visible only in the course of the on-going operations, etc.)
- Deficient transition- / transformation-planning (with ensuing procrastination of unsolved problems)
- Reduction in / loss of expertise with regard to the outsourced processes / applications
- Unclear definitions in the contractual agreements:
 - contract and Service Level Agreements do not match
 - documentation of transferred assets not precise enough
- Proper information of employees of the outsourcer is not ensured
- ...



Possible risks incurred in connection with Outsourcing (II / III)

- Loss of control over service standards / regarding the proper execution of the services provided
- Deficiencies with regard to monitoring the service provider properly
- Loss of information with regard to (recurring) problems and their origins
- Uncertainty with regard to the adherence of the provider to internal / regulatory requirements
- Dependency on third parties / other companies
- Changes / improvements in the quality of outsourced processes can be effected only indirectly
- Gradual deterioration of knowledge with an ensuing inability to supervise the execution of the outsourced functions / operations
- Prevention of the loss of informal contacts / know-how generally not ensured
- Differing corporate cultures between outsourcer and service provider cause frictional costs
- Loss of differentiation from competitors of the outsourcer (insofar that the outsourced services are recognized as an important differentiation characteristic)
- ...



Initiation /
Commissioning
Phase

Operation /
Monitoring Phase

Transfer / Insourcing
Phase

Possible risks incurred in connection with Outsourcing (III / III)

- Dependency on the . . .
 - business policy of the service provider
 - economic health of the service provider (requiring a periodic assessment of the financial stability of the service provider)
- Deficiencies with regard to the contract provisions with the service provider:
 - non-existing contractual requirements to document changes in routines, processes, etc.
 - short notice-period (e.g. three month) with regard to the termination of contract
- Asymmetrical information with regard to running the service
- Increased costs due to (a sudden) need to build up the facilities to run the to be re-integrated services
- Need to . . .
 - insource a service due to the non-availability / limited number of alternative service providers
 - rebuild resources and knowledge in a limited time
- Lack of interest in the provision of high qualitative services of the service provider in the transfer / insourcing phase
- . . .



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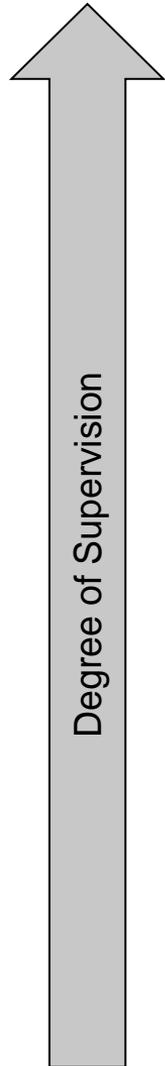
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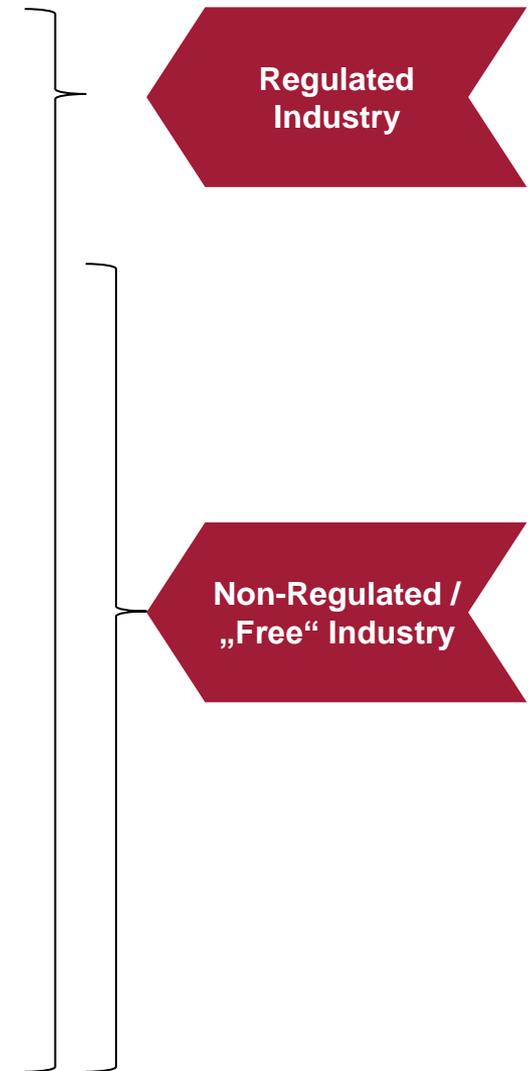


- Special legal / regulatory requirements:
 - MaRisk (VA) – Insurance Industry
 - MaRisk (BA) – Banking Industry
- Solvency II
- ...

- Generally applicable national legal requirements:
 - German law requires that adequate measures have to be taken – especially to establish a supervision system to identify any developments that might endanger the further existence of the company.
 - Respective national laws governing standards and procedures to ensure data security
- ...

- Economic considerations:
 - Ensuring the continuation of operational processes
 - Ensuring quality standards in production / services
 - Reputational considerations

- Industry and social standards / requirements (e.g. “Code of Ethics and Business Practice Standards for Outsourcing Professionals” of the Outsourcing Standards Board (OSB))



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A well defined governance is based upon clear-cut roles!

Roles

Outsourcing Project / Team

Coordination / Outsourcing-Controlling

Legal, IT, Compliance, . . .

Outsourcing Unit

Responsibilities

- Evaluates the business case for the proposed Outsourcing
- Assesses different options / service providers
- Defines requirements to be taken into consideration
- . . .

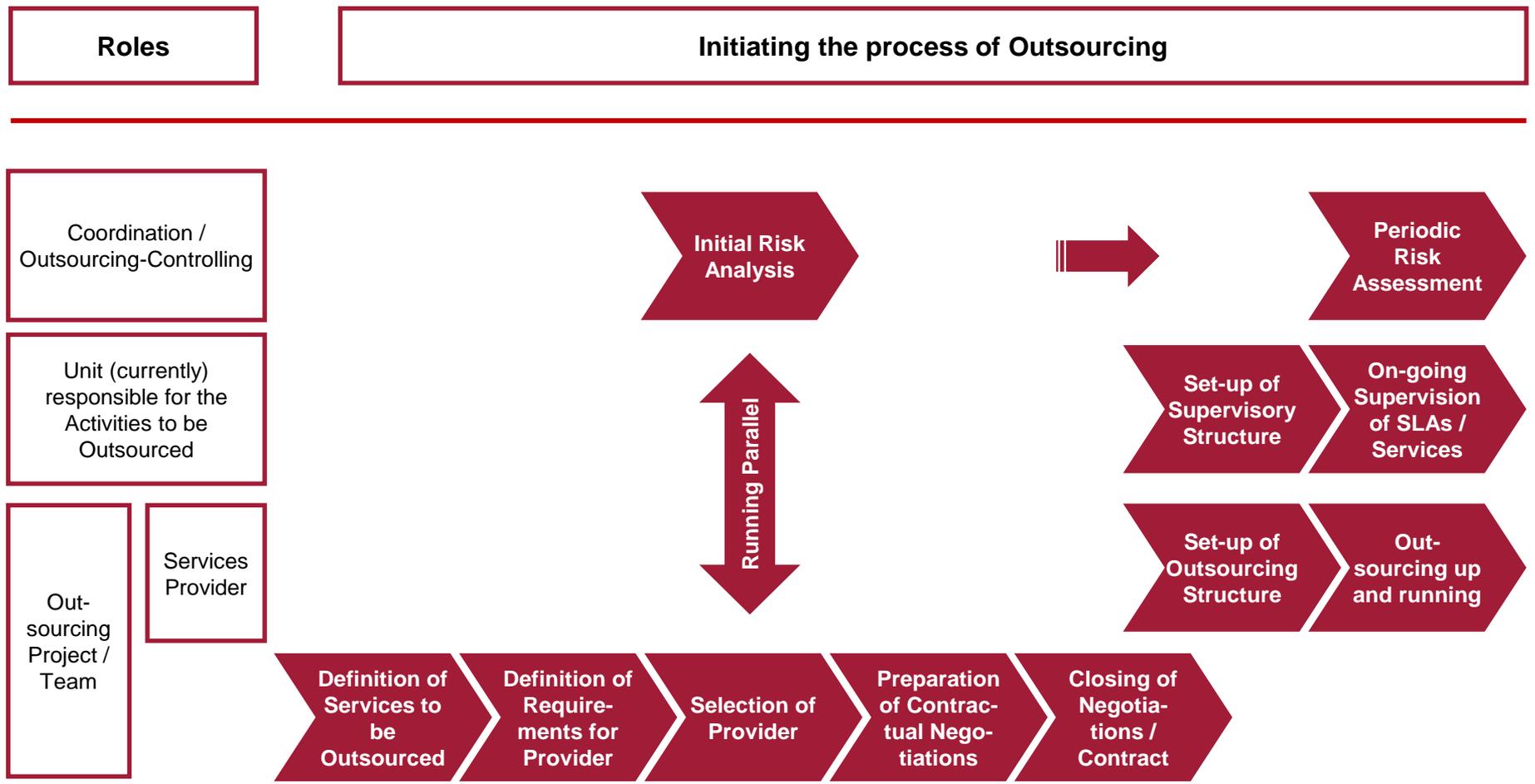
- Coordinates the analysis of risks / evaluation-process (initially and on-going)
- Uses standardized tools to evaluate the risks incurred
- Maintains the methodology / tools used for the risk analysis
- Escalates – where risks are surpassing pre-defined limits – to the management
- . . .

- Advisory function regarding the analysis of the Outsourcing endeavour

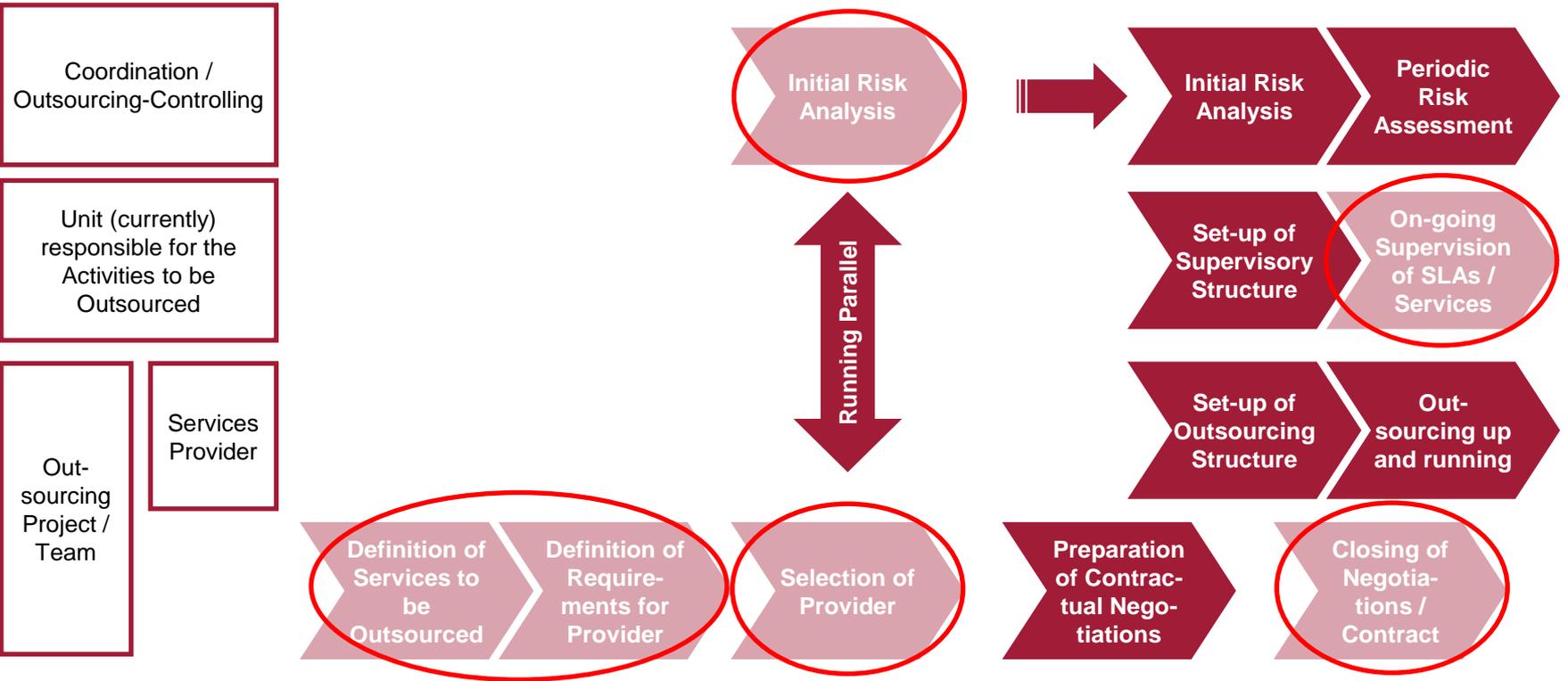
- (Currently) Responsible for the activities to be Outsourced
- (Ongoing) Supervision of SLAs / fulfillment of the stipulations of the contract
- . . .



The process should be set-up with the aim to keep risks at bay . . .



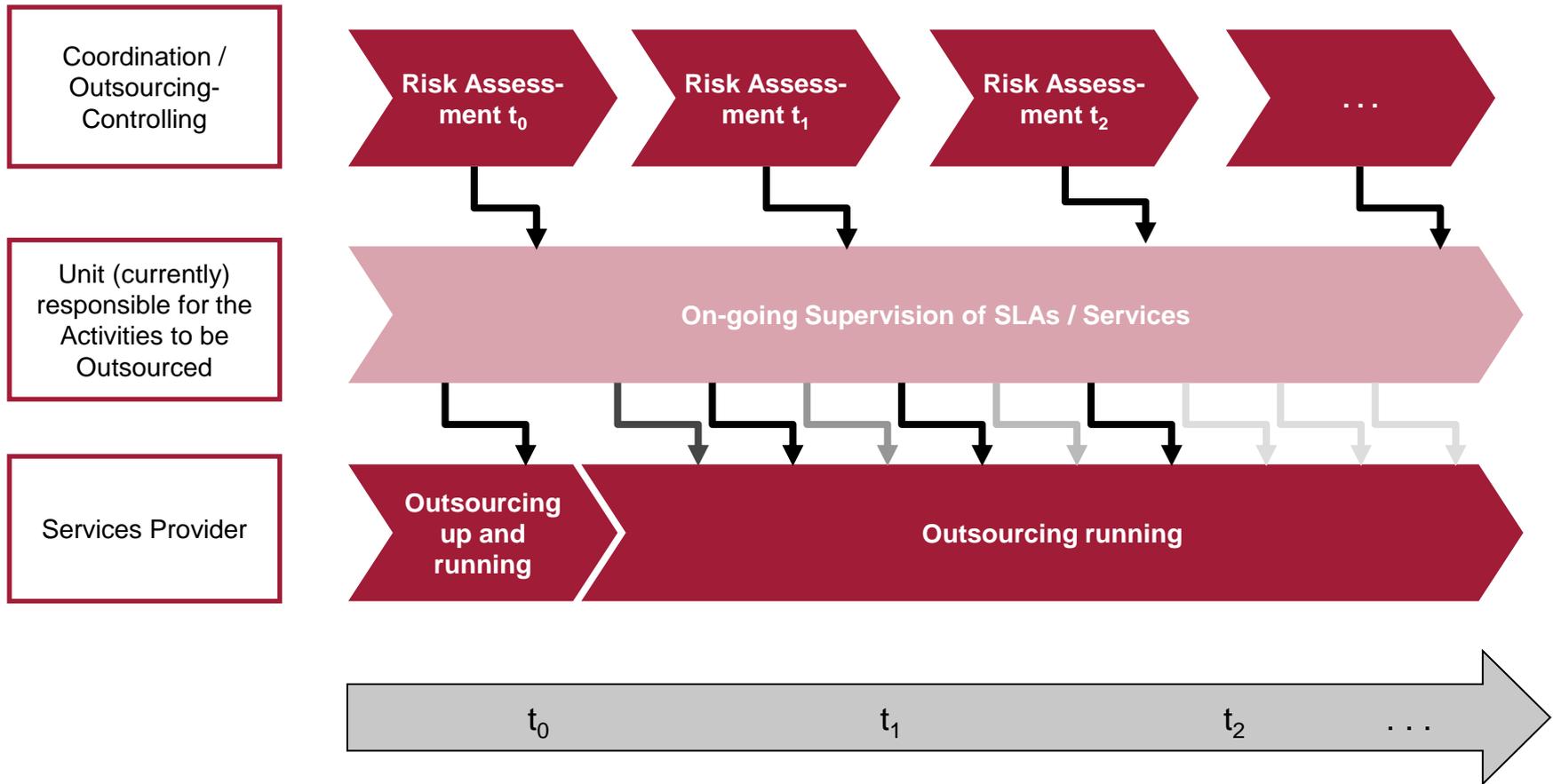
... nevertheless there exist common vulnerabilities even when such a process is set up!



A key vulnerability can arise in context with the proper supervision of the ongoing operations!



SwissLife





Extra- vs. Intra-Group-Outsourcing

Extra-Group-Outsourcing

- Companies are not related to each other in any way – the relationship is purely business driven.
- The relationship is defined via a contractual arrangement containing standardized elements, e.g.:
 - Contract is limited to a certain time period or is subject to a periodic review by the outsourcer.
 - Service Level Agreements are well defined, controlled / monitored and subject to a periodic review.
 - Penalties (as well as the criteria when they can be enacted) are well defined – in case that the criteria are met the pertinent actions are truly being taken!



The outsourcer is perceived as a client which generates profit but only when the contract is honored with an adequate service!

Intra-Group-Outsourcing

- There exists between the outsourcer and the service provider a direct or indirect – in terms of corporate ownership structure – relationship , e.g. being subsidiaries / affiliates of the same mother, mother company vs. affiliate, etc..
- The relationship is generally characterized by a weak awareness of the roles that each partner has in this venture, e.g. supervisory roles of the outsourcer is not taken so seriously.
- SLAs are not well defined and are not respectively can not be accompanied by pertinent penal action!



The outsourcer is perceived as a useful member of the corporate family which can share into the costs of running a part of the business!

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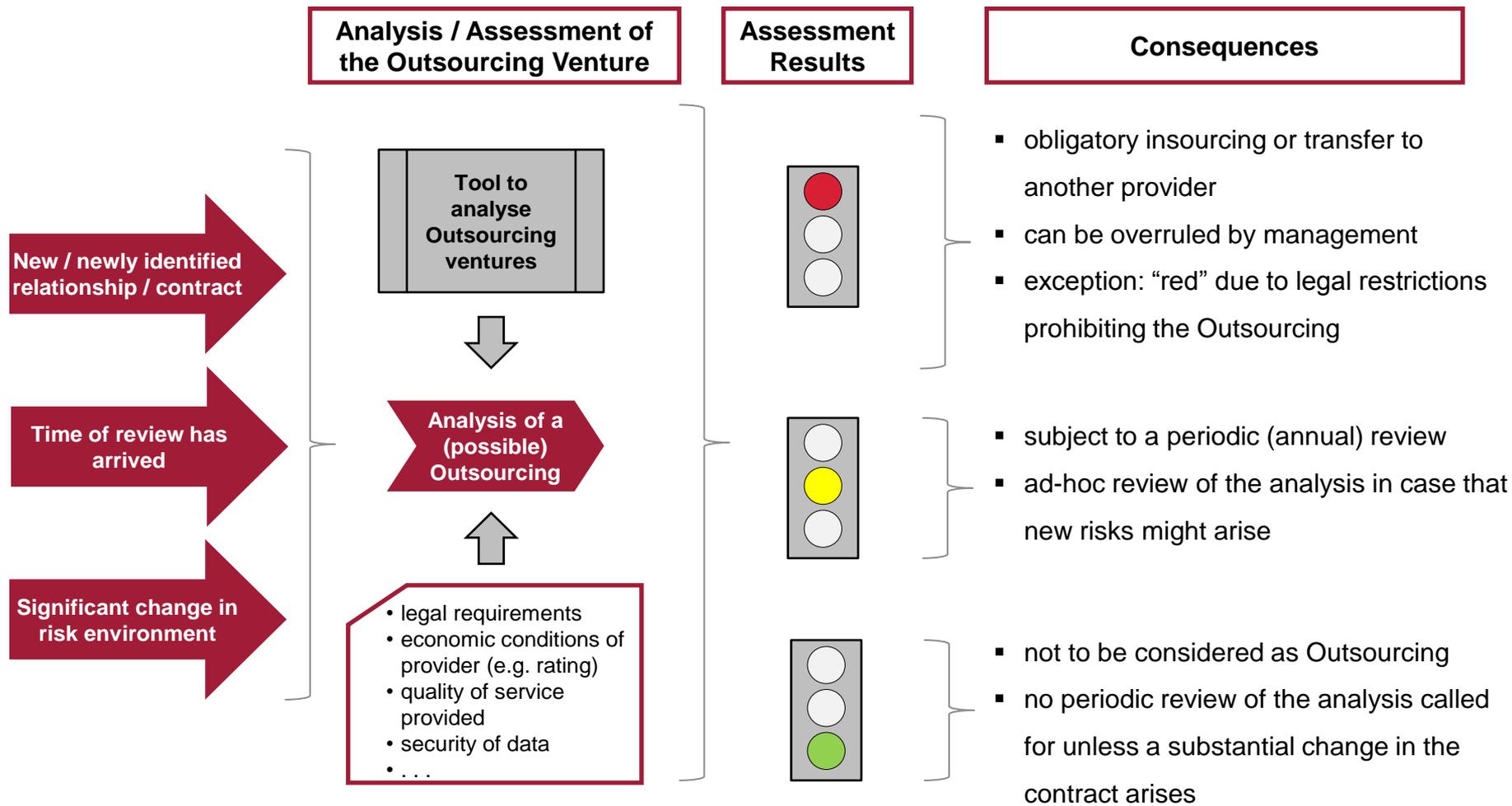
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The analysis can end with the dire conclusion that an insourcing is to be considered!



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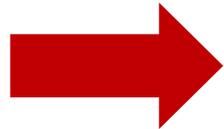
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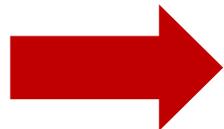
Lessons learned in dealing with Outsourcing

- Outsourcing endeavours are commenced mostly with economic and organizational objectives in mind. As a – usually – side-effect a reduction in the level of the risks incurred can truly be achieved.
- One has to keep in mind that outsourcing means only a mutation of the risks incurred:



Out of sight is not out of mind! The management responsibilities still rest with the outsourcer!

- If an effective risk reduction is intended certain rules have to be followed:



Strict observance and enforcement of the legal requirements regarding the outsourced functions by both parties (the outsourcer and the service provider)!

Clear delineation of roles / responsibilities over the whole period of the outsourcing endeavour!

Intra-Group-Outsourcing should always follow the same rules as “ordinary” (Extra-Group-) Outsourcing! The business case should follow a profit- and not a cost-oriented line!

Absolutely avoid a situation in which you are locked-in with the service provider and he can hold you hostage!

The (financial) health of the service provider as well as of the relationship proper should be kept in mind!

So fängt Zukunft an.