



SOCIETY OF ACTUARIES

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International Section News

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The Equation for Success

continued from page 24

the 1960s, 1970s, and 1980s has given way to single-digit inflation in most countries, opening up the individual life market.

United States

In the U.S., we are witnessing a significant shift in the product mix from risk to living-benefit products, such as annuities, mutual funds, and variable products. This trend is being driven by the graying of America and a significant change in the profile of the family, in which there are more single heads of households, more one-person households, and more unrelated households.

The U.S. industry is moving from a high-margin, low-volume era to a low-margin, high-volume era, and this equals higher productivity and better, more creative expense management.

Perhaps one of the biggest challenges facing the industry in the U.S. is bringing new people into the business. Recruiting was down 9% in 1995 and has been down in seven of the last eight years. Because of this downturn in recruiting, the field force is slowly dwindling. It is down from 241,000 in 1986 to less than 207,000 at the end of 1995. As a result, companies are reassessing and re-engineering their marketing and distribution systems and strategies and deciding what system or systems are appropriate for their company (banks, multiple systems, Internet, and so on). They are looking to technology to improve prospecting and customer identification, at worksite marketing to get agents in front of more prospects more efficiently, and at arrangements with banks for the same reason. The thrust of companies' efforts to be creative

in their marketing is to reach more people, but at a cost that is manageable.

Other major issues on companies' agendas are:

- Market conduct and ethical sales practices
- Focusing on core businesses (and the overall effectiveness and productivity)
- Strengthening the financial statement—in this regard, is a merger, acquisition or a strategic alliance an option that should be considered?

So there you have a quick perspective, a thumb-nail sketch of what is going on in our industry around the rest of the world.

Effectiveness in Administering Individual Life Insurance Policies

by A. Reg Munro

I am an actuary, but over the years I have been involved in many aspects of the life and pensions business undertaken by my employer, Old Mutual, based in Cape Town, South Africa. When I was asked to manage our Information Technology (IT) Division in 1990, among other functions, I was immediately faced with a new measurement challenge. Having come from a business unit where personal selling was a major part of the business, I was accustomed to having very detailed measures of progress, which seemed much more difficult in IT. We could benchmark our IT shop against other IT shops and measure people against the performance contracts negotiated with them. But when it came to measuring the value provided to the various businesses, we didn't even have a conceptual framework for measurement.

The critical breakthrough, for me, came when I realized that no measurement internal to the IT division

would provide this. The challenge then became finding a measure of the various businesses within Old Mutual that would demonstrate the strategic impact of their investment in IT. Fortunately, we already had an accepted method of allocating all centrally provided costs to the various businesses and this meant that we were able to develop measures that showed the impact of the increasing investment and expenditure in IT on the businesses. For each business a ratio similar to that proposed below was defined, and progress over time was tracked. Because the businesses are so different, varying from mutual funds to individual life to group employee benefits, comparing the ratios between businesses was clearly without meaning. Comparing the improvement trends, however, proved quite enlightening. One business was improving its measure by 50% every five years, while another was taking 30 years.

International Benchmarking

Throughout the world, there is an increasing interest in benchmarking against those companies that are perceived to be "best of breed" in some process or other. Several processes for this have been developed for life insurance companies, but almost all use the local currency as at least part of the exercise. This makes cross-country comparisons very difficult, because whatever currency conversion rate is used, severe distortions are inevitable.

For Old Mutual this is a particular problem because we are so large in our small industry. Although operating in a small country, we are assisted by the fact that when ranked by premium income expressed as a percentage of gross national product, the South African life insurance industry actually ranks as the top industry in the world with premium

continued on page 26, column 1

Effectiveness

continued from page 25

income equal to 13% of GDP, up from 6.5% 10 years ago. As a result, Old Mutual and its largest competitor both rank in the Fortune Top 50 life insurance companies. With the ongoing devaluation of the Rand against the U.S. dollar, it is doubtful that this high position will be maintained.

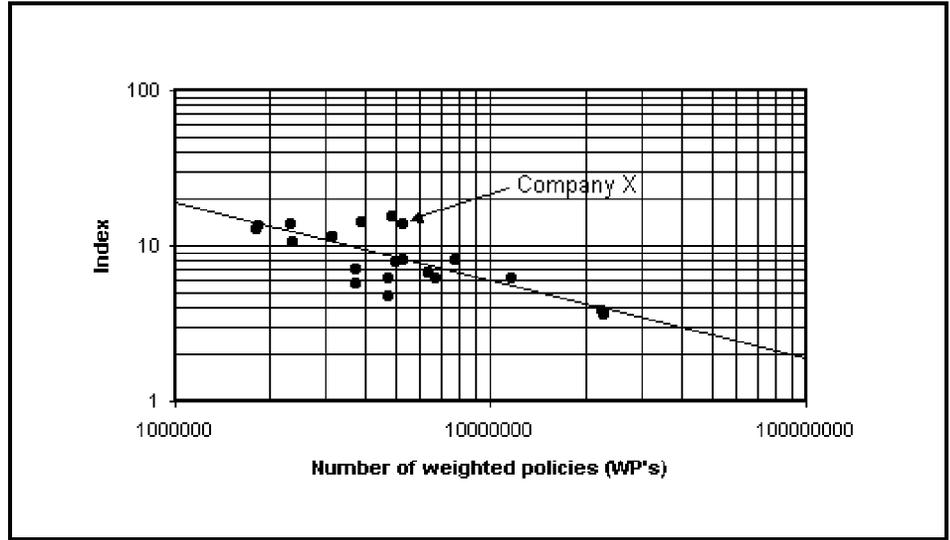
Therefore, we have been very keen to explore the benefits available from benchmarking internationally and to this end have developed a methodology that facilitates intercompany comparisons across countries. To enable the effectiveness of administrative processes to be measured in nonmonetary terms, costs have been converted from local currency to people equivalents (PEs) based on local conditions, workload has been expressed as weighted policies (WPs), and the ratio between them, that is, the number of PEs required per 10,000 WPs, has been used as an index of administrative effectiveness (IAE). Details of this relatively simple process are provided in the Annexure on pages 27 and 28.

Results Achieved to Date

For the past few years, a number of companies have provided data from which I have been able to calculate this index of administrative effectiveness. Over the years, the precise calculation method used has been significantly simplified and adapted as problems with earlier methods were resolved. Figure 1, therefore, contains results calculated on several slightly different bases, but the results are, I believe, a useful indication of what differences there are between companies around the world.

Figure 1 confirms the suspicion that there are significant benefits of scale in the administrative effectiveness of life insurance companies. The trend line

FIGURE 1
Index of Administrative Effectiveness
(Number of People Equivalents per 10,000 Weighted Policies)



shows a 40% improvement with every doubling of the number of weighted policies.

Figure 1 highlights two major implications for life insurance companies. First, companies can recognize how they compare with others and with the trend line. For example, Company X has an index of administrative effectiveness of 14 where the trend line for companies that size is close to eight. This implies that an improvement of 40% is required to get the company near to the trend line, let alone improve upon that.

Second, it reminds management that, even to remain in the same relative position, a company needs to improve its index of administrative effectiveness by 40% with every doubling of weighted policies. This is no mean achievement.

Request for Data

The results from the initial study are sufficiently revealing to encourage me to request interested life companies to send

me the data required, as listed in the Annexure. To make the submission of data easier and quicker, use our Internet Web site <http://www.oldmutual.com/adminsurvey>.

Once the results are in, I will see what conclusion can be derived from them. For example, I would like to explore the correlation between the degree of computerization and overall effectiveness. I will send the results and analyses to all companies that submit data to share any new learnings that emerge.

I trust that the proposals in this article will encourage you to invest the effort and short amount of time required to compile the required data and send it to me, so that together we can continue the search for meaningful measures that will help to improve both the value for money provided to policyowners and the profitability of our companies.

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ANNEXURE

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COMPANY DATA AND CALCULATION OF THE INDEX OF ADMINISTRATIVE EFFECTIVENESS

Please enter
the years here

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Year 1 Year 2

*See Notes on next page

Calculation of the Number of Weighted Policies WP (000's)

Formulas

A1	New Business Policies		
A2*	Weighted New Business	$A1 \times 4$	
A3*	In Force with Weighting of <i>M</i>	$M =$	
A4*	In Force A3 Weighted by <i>M</i>	$A3 \times M$	
A5	Other In Force Weighted by 1x	$A5 \times 1$	
A6	Total Weighted Policies	$A2 + A4 + A5$	

Calculations of Administrative People Equivalent (PEs)

B1*	Total Costs of Individual Life Business (000s)		
B2*	Less Costs of Selling (000s)		
B3	Total Administrative Costs of Individual Life Business (000s)		
B4*	Total Administrative People Costs (000s)		
B5*	Total IT Cost Component (000s)		
B6	Balance (000s)	$B3 - B4 - B5$	
B7*	Number of Administrative People		
B8	Cost per Administrative Person	$B4/B7$	
B9	Factor for use in C1 to C4 below	$A6 \times B8/10$	

Calculation of Index of Administrative Effectiveness and Components

C1	People per 10,000 Weighted Policies	$B4/B9$	
C2	IT PEs per 10,000 Weighted Policies	$B5/B9$	
C3	Other PEs per 10,000 Weighted Policies	$B6/B9$	

C4 | **Total Index of Administrative Effectiveness**

B3/B9		
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NOTES

If these notes are unclear, please feel free to e-mail me (rmunro@oldmutual.com) so that we can prevent unnecessary duplicated effort and so I can learn about the realities of life insurance business elsewhere in the world.

Throughout the Annexure, only individual life policies and the administration thereof is considered. All group or healthcare policies, and the associated expenses, must therefore be excluded. Because only administration costs are being examined, all selling costs must also be excluded, however, the administration costs of underwriting and setting up the records for new policies must be included.

A2. For New Business, a weighting of 4X is applied because of the additional work that is required. In my earlier study, I varied this weighting from 4X to 8X and found that the results were not very sensitive to changes in this weighting.

A3 and A4. Your company might regard some classes of in-force policies as requiring a different weighting. This section permits you to include such policies with the appropriate weighting. If you use this block, these policies must clearly be excluded from the number of policies included in A5.

B1. The total costs allocated to individual life policies is required here. Use whatever allocation basis your company uses for its own purposes.

B2. Because benchmarking of selling costs is outside the scope of this exercise, these must be excluded here. However, the administration costs of underwriting them and setting up the records for new policies must be included.

B4 and B7. These costs and the number relate to those people who are employed to underwrite, create the appropriate records, issue the policy documents, and administer individual life policies. Ideally, the costs include salaries, cost of fringe benefits, market rentals on space occupied, depreciation on furniture and other equipment used, and so on, but exclude those IT costs included in B5 below.

B5. This cost includes all the costs related to IT people (see note B4 and B7 above) including both the maintenance, operations, contractors, if any, and software development roles. Ideally this item would also include all mainframe costs allocated, as well as the costs (including depreciation) associated with PCs and departmental computers, but if these are not available, please include an estimate thereof.

Note: Clearly companies will have different protocols for allocating costs to business units, but these differences are probably not significant enough to destroy the value of the intercompany comparisons.

The company name can be included in a list of contributing companies **YES** **NO**

The company IAE can be identified in the resulting chart
(If this proves possible) **YES** **NO**

Company contact person for queries:

Name: _____

Company: _____

E-Mail: _____

Fax No.: _____