May 2010, Issue No. 30

SOCIETY OF ACTUARIES

Entrepreneurial Actuaries Section

THE INDEPENDENT CONSULTANT

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A Compensation Overhaul for the Sales Development of the Entrepreneurial Actuary

by Charles P. Preti

Executive Summary

Sales development—a term rarely used in the life insurance arena, particularly when it comes to describing actuarial duties. However, who better to "develop sales" for a carrier than the (entrepreneurial) actuary? In its basic form, developing sales requires two components: a product and someone to promote it. Traditionally these two elements have been separated, but this no longer is the case in our entrepreneurial environment.

This paper explores the issues and compensation to the entrepreneurial actuary who accepts the challenge of operating in a setting where true success is not measured by isolating theoretical profit margins or business sold, but rather focusing attention on the unfolding experience of what is hopefully to be truly profitable policies.

Business Problem

All life insurance companies have limited budgets, particularly when it comes to employing the services of outside consultants. This scrutiny is escalated when it comes to external product development actuaries, who are able to design, price and implement new and innovative products. After all, these are commonly the duties of company–employed individuals.

The first challenge for the entrepreneurial actuary is to gain the attention of senior management from the insurance company. Greater value than simply unique product needs to be offered. A committed organization, or group of organizations, who will support the marketing and sale of the product is a strong step toward transforming profit on paper to success on the streets. Creating this environment for the carrier will be a key aspect to this transaction.

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The best product and focused sales group still do not address the possible carrier expense limitations. The entrepreneurial actuary does not work for free. However, if deferring some or all compensation is an option, then we might just have the possibility of not only addressing budget constraints but also creating a climate where all parties—the carrier, sales organization, and entrepreneurial actuary—prosper proportionately to the business written.

Business Impact

The desire of many insurance company executives is to compensate all those involved in the sales process by providing substantial financial payments many years after the policy is sold. Often this has been viewed as a means of promoting persistency. However, this renewal form of remuneration sometimes comes at a price—inferior product performance, lower commissions when the policy is sold, or both. The intention of this paper is not to debate the merits of trail commission. Rather, it is to highlight the benefits of gently placing the entrepreneurial actuary in this land of sales development when it comes to structuring compensation. How those truly involved in the sales process are paid is somewhat independent—financial payments to the entrepreneurial actuaries are tied to quantifiable measures such as:

Number of policies sold
First year premium
Policy Accumulation Value

A deferral of income to the entrepreneurial actuary clearly has a cost. One dollar today is not the same as one dollar at the end of one year. Even if one places a time value of money at 10 percent per year, it would not be reasonable to expect the actuary to trade $1 today for $1.10 in one year, unless the certainty of payment was 100 percent. Two connected items are: (1) The defining of the amount to be deferred, and (2) The financial measurement to which the deferred income will be tied. All these points should be examined in a homogeneous manner.

The first step in the entrepreneurial environment is to depart from the traditional means of valuing the services provided by a sales development expert. The notion of basing compensation on time for service or even a fixed fare has to be retired. The truly accomplished realize the reward should only occur when the carrier, sales intermediaries and policy owner all are satisfied with the encounter. This occurs when a profitable product to the carrier is properly sold to a customer under a reasonable compensation structure to the sales intermediaries AND that product satisfies one or more needs of the policy owner. If this has been accomplished, and continues to be accomplished for many different policy owners, then the sales development process was properly performed. Compensation to the entrepreneurial actuary should therefore not be tied to the amount of work performed in order to arrive at this destination, but rather be based upon the success realized.

Of course, the entrepreneurial actuary should never be placed in a position where his or her motives could be second–guessed. The first priority should be the actuarial soundness of the design and assumptions. The goal of every product development assignment should be to create attractive customer–focused products, which meet carrier profitability targets and fall within acceptable risk parameters. This cannot change based upon the means by which the entrepreneurial actuary is compensated.

Carriers should embrace this model because it comes with a high probability of success due to the sales commitment. It furthermore lowers the upfront fixed costs associated with the product development process.

Solution

ABC Life Insurance Company wants to increase its sales of nonregistered deferred annuities. Their internal marketing team has determined that sales from an "exciting" new product can reach $10 million per month with their existing distribution outlets. Internal product development estimates the cost of getting making the product available for sale to be $1.5 million.

The independent entrepreneurial actuary proposes a unique and market-friendly product that is liked by carrier senior management. Profit targets can be obtained, and the risks associated with the new product are manageable. The sales organization supporting the sale of this new product is new to ABC Life Insurance Company, but they have an excellent reputation for delivering top–notch business. The premium commitment they offer is $20 million per month (i.e., twice that could otherwise be the case) plus, if they fail to deliver, a financial penalty is incurred and payable to the carrier to help offset product development costs.

In return for bringing product and distribution, the independent entrepreneurial actuary proposes that 0.50 percent of premium be paid to them in lieu of any upfront fees. They also will perform many of the duties the internal staff of the ABC life insurance company would otherwise have to perform. This reduces the development costs by 30 percent to $1.05 million (a savings of $450,000).

Traditional actuaries could have saved the time of internal resources, but estimates suggest this would have cost $600,000 to $700,000 for the same amount of effort. Critics of the independent entrepreneurial actuary are quick to notice that $20 million per month in sales means $100,000 of revenue to the outside organization. It will not take long for the payments to the entrepreneurial actuary to surpass that which the traditional actuary would have charged. Keep in mind, however, the traditional actuaries would not have brought distribution to ABC Life Insurance Company nor would they likely be willing to take the risk that the product does not sell as anticipated.

Perhaps this proposal is not the perfect solution for sales development seekers to follow. However if it serves as the quintessential model for which certain entrepreneurial actuaries may strive, then we may see a new landscape begin to take shape in the years ahead.

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