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EXPENSE CONTROLS

A. Have any simplified approaches in measuring and controlling expenses of life insurance companies proved practical?

B. Do the results of such programs provide suitable expense factors for calculating

(i) Ordinary premiums, policy fees, and dividends?

(ii) Group retentions?

(iii) Net interest rates from gross interest rates?

C. What are the current trends in expense rates?

MR. ROBERT H. JORDAN opened the discussion by commenting on the Life Insurance Company of North America's practice of establishing expense objectives, using, as guides, the Company's expense history and analyses of the expenses of other companies. Objectives are expressed in terms of unit expense ratios which Mr. Jordan described in his discussion of Agency Problems. The progress of actual expense ratios of the units is compared with the desired pattern of ratios and efforts are made to attain conformity. Mr. Jordan felt that expense rates of the general form described in his discussion of Agency Problems are satisfactory for calculating premiums, dividends, and asset shares.

It was MR. JASPER E. MOORE's opinion that the big problem in the area of expense controls is to find a straightforward way to improve the value derived from the home office salary dollar. The Crown Life has attempted to solve this problem by having supervisors design their own work control programs. Each supervisor defines work units which can be reported by his staff. The fact that a continuous record is kept of work done has a salutary effect on the work attitude of the individual employee. The program is intended to correct deficient supervision, and supervisors have adopted it as a valuable aid. The average salary cost per unit of output is determined periodically, and the trend of such unit costs and work loads gives a distinct picture to management as well as to supervisors. It was Mr. Moore's opinion that this approach has been effective in controlling expenses.

According to MR. LUMIR F. SLEZAK, the Occidental Life controls expense by means of a budget or estimate of the following year's expenses, assuming a certain volume of new premiums. Officers responsible for certain functions report their needs to the controller who determines the ratio of each major item of expense to the Company's total gross income. Ratios are plotted for about a dozen major accounts and the balance is grouped into "all other." A sharp change in a ratio or in the trend of a ratio points out an area where investigation of details may be necessary. Caution must be exercised when using these ratios and the changing distribution of gross income by lines of business must always be considered. For Mr. Slezak's company, the total ratio, excluding commissions, amounts to about 12%, with salaries and taxes each accounting for about 4% and the remainder accounted for by eight or ten accounts.

Commenting on expense trends, Mr. Slezak stated that since an increase in the ordinary expense ratio has been offset by a decrease in the group expense ratio, the total ratio for the Occidental Life has remained approximately constant during the last several years. The decrease in the group expense ratio was largely a result of an increasing volume of self-administered business. The total tax ratio for this company has increased substantially, principally because of the increase in federal income tax. Average salaries have increased sharply along with the cost of employees' benefits, and Mr. Slezak predicted that this trend will continue, as clerical salaries lag behind industrial wages. Increasing average salaries have been partially offset by increasing productivity of the clerical staff through automation and by the elimination of operations formerly thought to be essential. It was Mr. Slezak's opinion that the limits of these offsets will soon be reached and since salaries and taxes will continue to increase, the cost of doing business will increase.

MR. ARTHUR PEDOE referred to a paper on expenses which he will present at the first meeting next spring. The paper contains the results of an expense study based on the figures of twenty Canadian companies. Expected expenses were determined by formula and were such that, for the year 1958, the ratio of actual expenses to expected expenses for the twenty companies combined was 100%. The ratio for the ten larger companies increased from 99% in 1958 to 101% in 1959; and for the ten smaller companies, from 106% to 109%. The formula was applied as far back as 1939; and according to Mr. Pedoe, the trend has been consistently upwards. Although the study shows that there has been an increase in the average size of policy and the average premium per policy, Mr. Pedoe pointed out that the trend of the average premium per $1,000 of insurance has been consistently downward. The principal reason given for these trends was the increasing proportion of term insurance written at lower premium rates. Mr. Pedoe wondered if this business is self-supporting.

MR. DONALD C. MACTAVISH referred to two studies which the Mutual Life of Canada has found useful. The first is an annual study to measure overhead expenses for ordinary insurance. Expenses are broken down into first year and renewal per policy and per $1,000 of insurance issued and in force. Branch office expenses are analyzed on a somewhat refined basis, utilizing such tools as time studies, while head office expenses are broken down by first year and renewal by the armchair method. The errors introduced by this approximate method seem to compensate each other. Since the study is conducted on the same basis each year, it not only gives a measure of the way expenses are moving, but the results are also used for the calculation of premiums, dividends, asset shares, etc. According to this study, the Mutual Life of Canada's first year and renewal expenses per $1,000 have decreased approximately 20% during the period 1951–1959, but first year expenses per policy have risen 23% and renewal expenses per policy have risen 11%. This was explained by the fact that the average size of policies written is larger, while the number of policies written has increased only moderately.

The second expense study to which Mr. MacTavish referred measures the trend of expenses by using a modification of the Formula A which Mr. Pedoe applied in the intercompany expense study of the Canadian Association of Actuaries. The formula compares actual expenses with expected expenses expressed as a percentage of premium income, first year and renewal, and dollars per $1,000 of business issued and in force. The Company's expenses during the calendar year 1951 were used as a base to develop expense factors. Except for a small increase in 1952, the ratio of actual to expected expenses declined steadily from 100% in 1951 to 90.6% in 1957. The ratios increased slightly in 1958 and 1959 because of the fact that the company introduced a new commission scale with larger commissions payable during the first policy year as compared to the former scale. When the aggregate index was broken down into component parts, it was found that some of the indexes increased while others decreased since 1951.