

Title: An Approach of a Japanese Life Insurance Company to Profit Management

Speaker:

Hiroshi Ohashi

Mitsui Life Insurance Company Limited

Thanks:

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Abstract:

Mitsui Life Insurance Company of Japan demutualized in April 2004, and while preparing its demutualization, the management of the Company became aware that it was imperative to monitor and analyze on a timely manner how its profits were generated and to have a robust system to project the liability cashflows in order to increase value of the Company. Based on this apprehension, a team including actuaries and system analysts was created and began a project of developing a new Profit Management System (PM System) to satisfy such management's needs. This paper presents a brief overview of how the system was built, the current situation on how it has been utilized and the challenges to be tackled in the future.

1. Background

(1) Business plan to increase corporate value and the PM System's function in the plan

In May 2003, Mitsui Life, prior to its demutualization in April 2004, developed a new business plan in order to increase value of the Company. Four major objectives of the plan are listed below.

- a. To develop a new sales model to improve profitability and efficiency of sales force and to diversify sales channels and products
- b. To improve and stabilize investment results by reducing risk assets and establishing a robust asset liability management (ALM) system
- c. Strategic reallocation (restructuring) of management resources including personnel, field sales offices and operational costs
- d. To reform corporate culture and improve corporate brand by achieving a qualitative transformation through demutualization,.

By achieving the objectives above, Mitsui Life tried to improve customer satisfaction, strengthen profitability and sales forces, establish stable business base and increase corporate value. See Table 1 at the end section of this paper for a brief summary of this attempt.

The plan included reforming corporate management framework and personnel management framework. To reform corporate management framework, we need to develop a new management system to monitor the progress of the plan on a timely manner, which enables management to make right decisions quickly. To reform personnel management framework, we need to introduce a new personnel evaluation system which is based on the company's profit.

Mitsui's management realized that in order to provide necessary information to the management system and the personnel evaluation system described above, which were to be the basic infrastructures for reforming both corporate management framework and personnel management framework, development of a new profit management system, which enables them to monitor segmented profit information on a timely manner and to project liability cashflows, was needed.

Also the Company was to disclose its embedded value for investors relations (IR) information after its demutualization. (In fact, it was first disclosed for Fiscal Year 2005.)

(2) Requirements to the PM System

The management of the company recognized that developing the PM System had 4 objectives below.

- a. To monitor the progress of profit plan on a timely manner and improve investment result as well as productivity and profitability of sales force.
 - Keeping track of result of operations compared to our monthly plan on a timely manner.
 - Projecting result of operations to our annual plan on a timely manner.
 - Evaluating the impact of changes in profit performance indicators (amount of inforce business, persistency rate, etc).
- b. To provide information for the management of the company to help them make strategic decisions, such as restructuring products or sales channels.
 - Monitoring result of operations and projecting future profits by business unit, sales

- channel, product or market segment.
- c. To provide information for performance evaluation and link profits to personnel evaluation.
 - Providing information for performance evaluation by business unit, personnel evaluation and salary review.
 - d. To provide information for external reporting to improve management transparency as a stock company.
 - Providing information to stakeholders, such as policy holders, stock holders, investors, security analysts, to fulfill accountability.

2. Outline of the PM System

The PM System developing team aimed at acquiring current information and making future projection shown below to fulfill the requirements stated above. We thought that current information or future projection should be measured by business unit, sales channel, product or market.

(1) Functions of the PM System

- a. To recognize monthly or yearly result of operations
 - Insurance related results are recognized on a policy by policy (or rider by rider) basis.
 - Operational costs: actual monthly costs are recognized by each expense item.
 - Expenses directly traceable to a certain profit management segment are allocated to that segment.
 - Overhead expenses are allocated to each segment by certain rules.
 - Investment results: actual monthly investment results are recognized,
 - Investment results are allocated to each policy (or rider) in proportion to its reserves. Allocated investment results are summarized by each profit management segment.
- b. Short-term projection of monthly future cash flows
 - For a projection purpose, cashflows are assumed to occur once a month. Projection period is one year (or till the end of the fiscal year).
 - Insurance assumptions: We choose some model points (or representative policies), decide a set of assumption parameters (for example lapse rate), and project insurance related cashflows by model points.

- Operational costs are estimated by each expense item.
 - Expenses directly traceable to a certain profit management segment are allocated to that segment.
 - Overhead expenses are allocated to each segment by certain rules.
- Projected investment profit/loss is allocated to each policy (or rider) in proportion to its reserves.

c. Long-term projection of future cashflows

- Basic ideas are same as those of short term projection.
- Projection period is 10 to 50 fiscal years.
- We perform both “closed type” projection and “open type” projection. Closed type projection includes in-force business only, while open type projection also includes future new business.

(2) Relation between needs and functions of the PM System

Table 2 at the end section of this paper shows relation between needs and functions of the PM System.

3. Process of developing the PM System

(1) Phases of the development

When we developed the PMS, we set 3 phases.

In phase 1, we developed prototype system using existing data. We considered the definition of monthly profit, how to recognize that, segments and indicators of profit management, and allocation rules of operational cost and investment profit/loss.

In phase 2, we developed a new system with monthly and yearly output. By using this new system, we developed a database which contained monthly insurance-related result, operational cost and investment result by policy and by rider.

In phase 3, we considered how to project future cash flows, and developed a new system.

(2) Members

In order to develop the PM System, the Financial Management Department of the company organized a project team including actuaries, system analysts, members taking charge of operational cost or investment. The project team was divided into 3 small teams. The first one was an actuarial team, the second one was an operational

cost team, and the last one was an investment team, and each team dealt with their issues. We actuaries played a key roll in this project from the beginning of planning the PM System. Of course, we actuaries participated in 2 other teams if necessary. In phase 3, we retained an actuarial firm to develop a future projection system.

(3) Schedule

We began considering the development of the PM System in 2003, completed the development of the phase 2 on February 2005 and the phase 3 in 2006.

4. Current usage and next steps

(1) Current usage

Since the completion of the PM System, the Company has used the system as follows.

a. To provide information for profit plan control

The profit plan control cycle of the Company is shown below. The PM System can provide profit information for each step of the cycle. Profit information is prepared mainly by Financial Management Department, in cooperation with Corporate Planning Department and Marketing Management Department, and is shared among them and Investment Department. It is reported to executives, if necessary.

- b. To provide information for management decision
 - Actual profit performance by product, by rider, by sales channel, etc
 - Profit projection for in-force contracts
 - Profit projection in developing new products

- c. To provide information for performance evaluation
 - Used for evaluating sales units and sales personnel
 - EV-based contract value by product, by age, etc.

- d. To provide information for external reporting
 - Embedded Value for IR information

(2) Next Steps

- a. To provide information on a timely manner

As stated in the previous paragraph, in the profit plan control cycle, the PM System information is rarely used for step (4) or (5), because information is not provided timely enough for implementing step (4) or (5).

One reason for that is a lack of skilled personnel in user sections. For now, skilled personnel who can fully utilize the PM System only belong to the Financial Management Department.

Our next step is to share skills to fully utilize the PM System with user sections, thereby enable user sections to grasp necessary information by themselves. By doing this, utilization of the PM System will be improved much further.

- b. Application for ALM and for possible new regulations

The Company owns many long-duration contracts with high interest rate guarantee. I think it necessary for the Company to control interest rate risk, considering the possible introduction of IFRS and economic based solvency regulations.

Now we can project liability cashflows more accurately than before using the PM System. Along with improved information provided from asset side, we can manage economic based surplus and implement a more sophisticated risk management.