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UPPER CANADA INSURANCE

David Wood wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author might have disguised certain names and other identifying information to protect confidentiality.

It was early Monday morning on October 19, 2009, as Deborah McDonald reviewed the data on her desk. McDonald, a business integration specialist at Upper Canada Insurance in Toronto, had just spent the weekend reviewing the information that her team had collected on the company's life insurance application process. About a month ago, McDonald had been asked to lead a team that would address the inefficiencies in this process, largely due to high numbers of applicants withdrawing from the system (referred to as "wastage" in the insurance industry) in the midst of the process. Although it was not unusual to have some wastage, the data indicated that Upper Canada Insurance's rates were well above industry standards, and senior management was becoming impatient. McDonald had until the end of the month to present her assessment and recommendations.

THE LIFE INSURANCE INDUSTRY

The origins of modern life insurance could be traced back to the 17th century in England and to as early as 1734 in the United States. It was not until the 1840s, however, that life insurance really became an industry. The widespread publication of natural disasters in both New York and Chicago and the reversal of a church policy that had previously banned life insurance led to rapid growth over the next 100 years.[1]

By 2009, the insurance industry had become highly competitive, with five companies in Canada accounting for 59 per cent of all premiums. Consolidation had been a continuing trend, as there were 163 insurance companies in Canada in 1990. Legislative changes in 2001 also permitted chartered banks to enter the insurance industry, thereby creating even more competition and lower margins. A growing number of companies competed on price and began to sell directly to consumers. The traditional insurance agent was being replaced by the use of technology, especially the Internet, but an ongoing challenge remained in that companies still needed to provide a high level of customer service.

While most companies offered auto, property and casualty insurance, life insurance remained one of the largest segments of the market, with 25 per cent of all premiums. Most life insurance fell into one of two

[1] *http://EzineArticles.com/?expert=James_J._Robinson*

types: whole life, which covered the client through death with a guaranteed payout; and term, which covered the client for only a specified period of time with no guaranteed payment. Term was significantly less expensive and was seen as being more practical, since people often did not need insurance to protect their family into retirement.

UPPER CANADA INSURANCE

The Bank of Upper Canada (Upper Canada) was one of several large financial institutions in Canada, with over $345 billion in assets under administration and an eight per cent Tier 1 capital ratio[2] in 2008. Upper Canada was well diversified, with clients and operations around the world and business operations in retail banking, wealth management, wholesale banking and insurance.

Although insurance was a relatively new focus for Upper Canada, it was also one of the bank's most important business segments. In 2008, insurance made up 18 per cent of all revenues and generated a 33 per cent return on equity (see Exhibit 1). Upper Canada Insurance sold home, auto, travel, health and life insurance through third-party channels, including life insurance advisors and travel agents. In addition, Upper Canada Insurance had developed a growing proprietary channel, such as retail insurance branches, bank branches, call centres and online access. Insurance products were seen not only as a growth opportunity, but also as a part of the company's larger strategy to diversify its financial services to existing clients and appeal to clients that had not previously been served by Upper Canada.

UPPER CANADA TERM LIFE

Upper Canada's life insurance product was term life funded through premiums that were collected monthly, quarterly, semi-annually or annually for the duration of the insurance policy. Most applicants used term life insurance because it was a cost-effective way of protecting their family in the event of the policy owner's death. Term life insurance was usually designed to expire after the applicant's children had reached an age where they were no longer a dependant or at the time the applicant planned to retire. Most term policies therefore had a 10-year term.

On average, term life insurance had a death benefit of $331,000 and cost $573 per year. Upper Canada Insurance made the majority of its income on investment returns on the premiums paid. Based on Upper Canada's current internal rate of return and the actuaries' expected pay-out, the average gross margin on a policy was roughly 31 per cent.

LIFE INSURANCE APPLICATION PROCESSING

Life insurance applications were generally processed in very much the same manner regardless of the sales lead. However, because Upper Canada Insurance had organized the application approval resources by sales channel, it was the 64,200 direct sales applications processed annually that concerned McDonald.

One of Upper Canada's 16 life insurance advisors (LIA) first had to complete the initial application with the applicant over the phone. This stage included asking each applicant a series of qualifying questions to verify that they were eligible for life insurance. The LIA also completed a needs analysis, which was in

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[2] *Tier 1 capital is comprised of common stock, retained earnings, and non-redeemable non-cumulative preferred stock.*

turn used to provide a quote. Generally, this process took eight minutes, followed by the application process itself, which took an additional 17 minutes.

The application was then sent electronically to one of the eight case co-ordinators (CC). The CC would print the application and, every three to four hours, would take all the applications from the fourth floor to the copy centre in the basement to have them scanned and uploaded to a secure website. Although it took the CC only a few minutes to prepare the applications, the scanning and uploading process could take up to 25 minutes, depending on how busy the copy centre was at the time.

A third-party processor in India accessed the applications through the secure website and entered all the information into Upper Canada Insurance’s central database at a cost of $3.71 per application. This process was estimated to take only about five minutes, but because of the difference in time zones, the application was not usually available for the CC to audit until the following day. The CC then spent 11 minutes auditing the application in the database and correcting any errors or completing any missing information. Once the file had been audited, the CC prepared the application for review by one of eight underwriters (UW).

The UW spent eight minutes reviewing the file and determining what type of medical information was required. In over 95 per cent of all cases, the UW requested that a phone interview should be completed by the third-party health investigation firm. On average, this phone interview took 40 minutes, but before that, it often took a week or more to reach the applicant at a convenient time. In the remaining cases, the UW requested both a phone interview and either a medical or some lab work. Because of the additional time to schedule the medical or the lab work, it generally took an additional two weeks for Upper Canada Insurance to get the results. Regardless of the medical information requested, the third-party firm handled all medical related work, charging $45 for each phone interview and an additional $18 if the applicant required a basic medical or some lab work.

All medical information was then returned to the CC, who compiled all the information and prepared the file. This took the CC only five minutes, at which time the completed file was submitted to the UW for a final decision. Within eight minutes, the UW would make a decision, thereby completing the application process. Clients were then informed of the company’s decision and a policy, if approved, was written. In total, the application process took five to seven weeks to complete and was estimated to cost $600 to $700 per application.

WASTAGE

“Wastage” was a term used in the insurance industry to describe all applications that, for one reason or another, never reached a final decision. In the life insurance industry, there was a relatively high level of wastage, with most industry statistics putting the number as high as 38 per cent, although some companies had levels as low as 32 per cent. Upper Canada Insurance had a wastage rate of 45 per cent on life insurance applications that were solicited directly from the client. Of utmost concern was the fact that 44 per cent of all wastage at Upper Canada Insurance occurred because the client abandoned the application process (see Exhibit 2).

Through consumer surveys, Upper Canada Insurance had determined that the No. 1 reason for clients abandoning the application process was the long time required to get a response, followed by a lack of communication and poor customer service. In fact, Upper Canada’s managers believed that if they could solve this problem, they would be able to meet or exceed industry wastage levels and improve the efficiency of the direct sales application processing team.

McDonald was assigned the task of analyzing the data and making recommendations to resolve the issues in the application process at Upper Canada Insurance. Her background as an Ivey grad and Six Sigma black belt made her ideally suited for the job. McDonald knew there were numerous opportunities to make improvements to the process, but given management's expectations and the limited timeframe, she was not certain where to begin.

EXHIBIT 1: BANK OF UPPER CANADA 2008 RESULTS BY BUSINESS SEGMENT

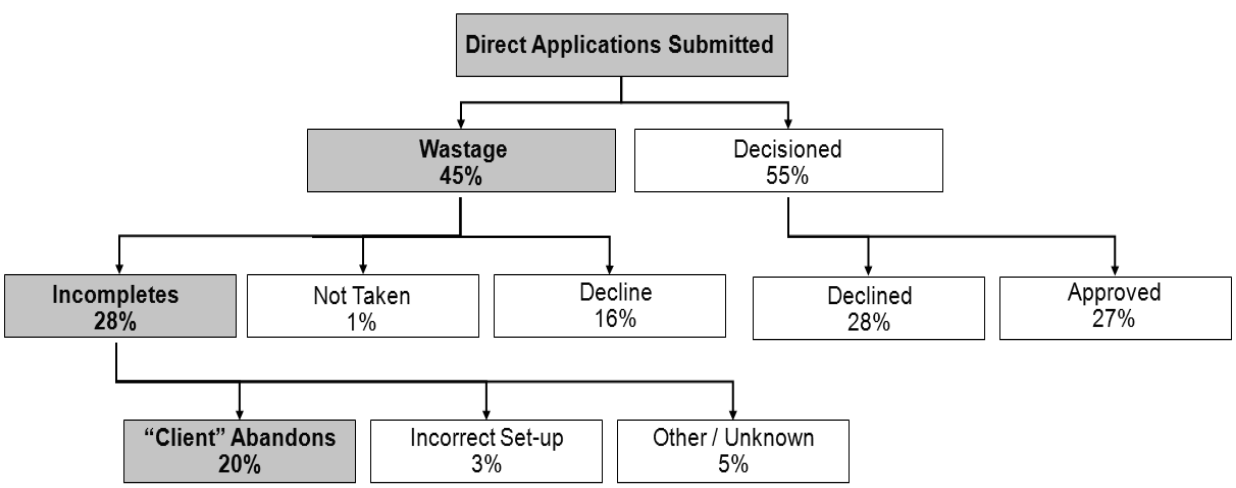
Results by Business Segment

(millions of Canadian dollars)

2008	Canadian Banking	Wealth Management	US Banking	Wholesale Banking	Insurance	Corporate	Total
Net interest income	$ 3,532	$ 212	$ 1,308	$ 804	$ -	-$ 651	$ 5,205
Non-interest income	$ 1,852	$ 1,208	$ 520	-$ 41	$ 1,984	$ 204	$ 5,727
Provision for credit losses (recovery)	$ 467	$ -	$ 138	$ 65	$ -	-$ 21	$ 648
Insurance policyholder benefits and expense	$ -	$ -	$ -	$ -	$ 1,369	$ -	$ 1,369
Non-interest expense	$ 2,758	$ 985	$ 1,093	$ 731	$ 351	$ 229	$ 6,148
Net income before income taxes	$ 2,158	$ 435	$ 598	-$ 34	$ 264	-$ 654	$ 2,767
Net income	$ 1,479	$ 469	$ 440	$ 40	$ 254	-$ 90	$ 2,593
Total Assets	$ 105,157	$ 9,393	$ 77,468	$ 131,158	$ 9,576	$ 12,384	$ 345,137
2007	**Canadian Banking**	**Wealth Management**	**US Banking**	**Wholesale Banking**	**Insurance**	**Corporate**	**Total**
Net interest income	$ 3,295	$ 194	$ 833	$ 534	$ -	-$ 631	$ 4,224
Non-interest income	$ 1,737	$ 1,217	$ 356	$ 988	$ 1,547	$ 190	$ 6,035
Provision for credit losses (recovery)	$ 371	$ -	$ 73	$ 29	$ -	-$ 80	$ 393
Insurance policyholder benefits and expense	$ -	$ -	$ -	$ -	$ 1,068	$ -	$ 1,068
Non-interest expense	$ 2,596	$ 946	$ 745	$ 769	$ 299	$ 418	$ 5,773
Net income before income taxes	$ 2,065	$ 465	$ 370	$ 723	$ 181	-$ 780	$ 3,024
Net income	$ 1,374	$ 465	$ 195	$ 503	$ 175	-$ 99	$ 2,613
Total Assets	$ 92,781	$ 9,089	$ 35,868	$ 108,092	$ 7,948	$ 3,666	$ 257,444

Source: Bank of Upper Canada 2008 Annual Report

EXHIBIT 2: WASTAGE DATA



Source: Company Files