# ROLE OF THE ACTUARY IN CORPORATE PLANNING

1. The technique of corporate planning—what is its purpose and value?
2. What is the role of the actuary in the setting of objectives?
3. In what ways can the actuary assist in the translation of these objectives into meaningful plans of action?
4. What is the actuary's role in the necessary financial testing of these plans to meet objectives?
5. What controls and reporting mechanisms are required to check that the objectives set are, in fact, being met?
   *a*) Does the actuary have a role to play here?
6. What is the nature of the projections required for corporate planning in an insurance company?
   *a*) What has been the practical value of these projections?
   *b*) Do they assist the actuary in other areas of his work?
7. What manpower and organizational structure are needed for effective corporate planning?

*Philadelphia Regional Meeting*

MR. JOHN M. BRAGG: My remarks are largely directed at the technique of corporate planning—what should be done and how to go about doing it. I will try to outline a pattern by which corporate planning can be done.

The term "corporate planning" is a very large umbrella. It can cover almost anything we want to put under it. I will not attempt to deal with all possible aspects. What I am going to attempt to do is to put the various major steps in a logical order.

First, I believe it is necessary to consider the role of the industry itself. Much interest is being shown in this question at the present time. Our role is a noble one, because it involves assistance to all people in times of need. But other organizations, including government, have joined us in the attempt to fulfill this role. We need to try to clarify or redefine the role of our industry.

Much consideration is being given, for example, to enlarging the scope of our operation to include mutual funds, variable products, consumer finance, and so on; in the health insurance area we see plans to move the industry from a mere financing mechanism into some aspects of control of the provision of care itself. These are examples of an assessment of the role of the industry—the first step in corporate planning.

Second, we need to define the role of our individual companies within the industry. This will lead to philosophy defining the geographical areas to be served, the economic strata to be reached, and the classes of products to be offered. These matters should be decided by deliberate planning. Too often our companies just seem to drift; they seem to have no stated philosophy. Company philosophy of this type should often be reviewed and must be effectively communicated to all personnel.

Third, corporate planning must deal with organizational decisions. This is a matter of planning for and setting up the operating staff that will be required, both in the field and at the home office, to carry out the company's role. This includes provision for training personnel, both now and in the future.

The fourth step concerns "operating decisions," as I call them. Primarily they concern themselves with the levels to be aimed for in mortality, morbidity, and persistency. These matters, also, should be planned and should not be allowed to drift. Too often, I think, there is a vague, unplanned feeling that the company is trying to secure the "best" results in these areas. This type of thinking may be wrong, not just because it is unplanned but also because the "best" goal could be entirely wrong for the particular company, considering the markets it has decided to serve. Basically, these are matters of underwriting philosophy. They have a crucial connection with sales activities. These matters concerning underwriting philosophy should be carefully planned.

The fifth step in corporate planning concerns itself with three matters inextricably woven together—prices, the field compensation system, and what I refer to as the "sales attempt quota." Taken together, these are the matters which are bound up with successful operation for the company and its field force. I will make separate comments about each of these three subjects.

Prices should not be too high or too low but at the best level—the level which will help the company and its agents to achieve the best possible degree of success over a lengthy period of time in the future.

The field compensation system is a tremendously important matter for the corporate planner. It is also a most intriguing subject, and I believe that actuaries should be far more concerned with it than they have been in the past. We should recognize that the sales interview is the most important thing which happens. Our entire existence, as companies and as field forces, depends on sales interviews. Enough of these must occur and enough of them must be successful. The field compensation system should keep this in mind.

Many new developments are occurring in field compensation, and more will occur in the future. I refer to such things as salary plans, stock bonus plans, profit-sharing plans, and—for the future—computerized prospecting and the interview fee.

The sales-attempt quota is not really a sales quota in the traditional sense. It should be looked at as a "prospect seeing quota." However, it seems to be an essential part of corporate planning—but, I might add, a part which is seldom present. As I mentioned just a minute ago, I think it is interwoven with the questions of prices and the field compensation system.

Last, I think that corporate planning should concern itself with something called the "total marketing concept." This is a concept under which the entire organization, in the field and at the home office, is dedicated to studying the needs of the prospect and to everything possible which will increase the number of sales interviews and the success rate.

The points I have outlined provide a track to run on in performing corporate planning. Of course, corporate planning does not happen of its own accord. We need to plan to plan. Actuaries can perform a major role in pointing out these matters and can engage in the planning itself. However, it is basically a job for management as a whole. Some type of formal organization, through committees or other agencies, is necessary to accomplish it. Continuous checks are needed on the results. I will not attempt to go into detail on these matters.

MR. WILLIAM A. SPARE: I will refer to each of the items under discussion in order.

1. The basic purpose of corporate planning is to achieve a set of objectives by following a predetermined course of action. If a predetermined course is not set, the company will probably tend to proceed in much the same direction as it has in the past. Because of the nature of a life insurance company, it may take many years before the impact of a current decision is felt. Thus it is essential that life insurance companies be in a position to measure the long-term effect of current actions. For example, a change in underwriting requirements may not be reflected in mortality results to any great extent for a great many years to come. A change in investment policy will have little effect on the over-all rate of return of the company in the first few years following the change.

The three fundamental steps in the management cycle are planning, organizing, and controlling. Although many departments or areas of a company may make short-range plans covering what they want to accomplish during the next year or so, it is important that there be an over-all co-ordination of effort so that these plans complement each other and do not conflict. In today's competitive atmosphere it is essential that companies carefully plan their over-all course of action. The value of corporate planning is that it co-ordinates and channels company efforts in one direction so that people are not working at cross-purposes.

2. One of the key elements in a corporate plan is to set objectives to be met at fixed times in the future, say, five, ten, or twenty years. These objectives may include production goals, investment results, surplus ratios, size of agency force, and so on. The role of the actuary in setting objectives would certainly include determining whether these objectives are reasonably attainable. Can production goals be met? Are expense goals realistic? Are objectives compatible among various departments? Most long-range objectives should be defined in specific terms and must be measurable. The actuary's knowledge of the over-all operations of the life insurance business make him the ideal person to determine whether objectives are realistic. Objectives which cannot be attained under any reasonable set of circumstances should not be set.

3. The actuary's over-all knowledge of life insurance operations makes him the logical person to take on the job of translating objectives into meaningful plans of action. For example, suppose that an objective has been set to improve the mortality ratio by several points at the end of ten years over what the ratio would have been if current mortality trends continue. The actuary can assist in revising underwriting rules and reinsurance arrangements which may be necessary to help bring about this improvement. In the case of a growth objective, the actuary can assist in the development of new products to improve the sales picture.

4. The actuary's facility with forecasting methods can be used to great advantage in testing the financial consequences of a corporate plan. Many companies now make short-term forecasts for purposes of justifying the following year's dividend scale or testing the following year's operating-expense budget. Our own company makes a detailed estimate each October when the actuary presents to our board of directors an estimate of changes in surplus for the current year and for the following year. The current-year estimate is used to support the dividend scale which is being recommended for adoption for the following year. At the same time the controller presents the recommended expense and tax budget for the following year, and these figures are reflected in the actuary's estimate of changes in surplus for the following year.

In our company we estimate gains from operations on insurance, capital gains and losses on investments, the increase in the Mandatory Securities Valuation Reserve, and any special transactions which might affect surplus. With respect to gains from insurance operations we use the gain-and-loss approach and estimate gains from mortality, loading, interest, surrender, disability, and accidental-death benefits. We use model-office work to a considerable degree to obtain our required interest, tabular cost, and loading estimates.

For companies which now make short-range forecasts, it becomes relatively easy to extend the methods to longer periods of time, although, of course, the longer the period of time the less accurate the forecast will be. In any event, it is usually the actuary who is most familiar with the techniques of forecasting, so it will be the actuary who will be called upon to test the financial consequences of a corporate plan.

5. Long-range objectives are usually broken down into short-range goals which act as stepping stones on the road to the main objective. There must be an integrated system of reporting actual results in order to check on the progress of the plan and to see if the short-range goals are being met. Controls must be instigated to determine whether we are at the proper place along the road to meeting our objectives. The actuary has an important role in the preparation of such reports. He is ideally suited to interpret the results to ascertain whether objectives are being met or, if they are not, what changes have to be made in the plan to meet the objectives or what changes must be made in the objectives themselves.

These reports will basically consist of a comparison of actual results with the projected results for the period under study. The reports must be quite extensive, because they must cover all the various subgoals which have been set. To be meaningful, a comprehensive set of data must be accumulated and reported.

6. The projections which are required for corporate planning in an insurance company include such items as the summary of operations and the balance sheet in addition to various measures, such as the amount of insurance paid for, the amount of insurance in force, the composition of the agency force, interest rates, and so forth. A model office of the company's operations seems indispensable. This model office must be quite detailed and must include not just a distribution of business in force by plan and age but must also show other facets of the company's operations which are being tested, such as investment composition, composition of the field force, expense ratios, and so forth. A detailed model office can certainly be helpful to the actuary in other areas of his work, such as the preparation of dividend scales and the testing of premium rates.

7. The manpower and organization structure needed for effective corporate planning will vary with the type and size of the company. Large companies probably will have a large planning department, which would certainly have several actuaries on its staff and may very well be headed by an actuary. In small companies the planning function may be the work of only a few people, with an actuary very likely being included in the group. However, with more and more nonactuaries becoming trained in computer science and statistical analysis, there are more and more nonactuaries who are becoming expert in the forecasting process. In any event the planning work should be headed by the person best qualified.

The heads of major areas of the company's operations should, of course, be represented in the planning work since it is important that the efforts of all departments be co-ordinated. Persons working in the corporate accounting area should also be included because of the necessity of preparing a detailed system of reporting actual results.

MR. CLAYTON L. JACKSON: The purposes of corporate planning should be the following:

1. To establish what a company desires to and can accomplish;
2. To establish a set of goals that are (*a*) consistent, (*b*) possible to attain, and (*c*) difficult enough to stimulate company personnel;
3. To encourage as many as possible of the personnel to identify with the company by participating in the planning; and
4. To communicate to all personnel the desired accomplishments and goals so that all may work toward them.

The actuary must, of course, share in the company's planning in the same way that all other officers must. As a company officer, he must inform the planning center of any factors arising from his area that must be taken into account. Again, as a company officer, he must contribute to the review of suggestions from other areas and to the over-all review of plans before they become final.

An actuary is well qualified to direct the planning activity because of his intensive training in all phases of the insurance business, broad knowledge of the industry, and contact with many departments of the company. However, a planning operation can be successfully conducted by someone without actuarial training, provided that he has the necessary broad outlook and can obtain the technical actuarial assistance where necessary.

The actuary is especially well adapted to making the necessary financial tests of plans, specifically to test whether financial objectives are consistent and the probable outcome of different actions.

The actuary's training in model-office techniques enables him to prepare projections based on different assumptions on matters within the control of the company, such as expansion of the agency force, amount of new business produced each year, and concentration on one line of business rather than another, so that the most attractive goals or means of attaining goals may be chosen. In respect to factors over which management has little or no control–such as, for example, general level of mortality, general level of expenses due to inflation, or general level of interest rates—alternative projections can be made based on (*a*) optimistic assumptions, (*b*) pessimistic assumptions, and (*c*) most likely assumptions, so that the range of the financial results may be determined, in order to make a choice of goals or of the means of attaining goals.

In order that goals will be meaningful and attainment may be tested, they should be expressed in numerical terms; for example, a goal for insurance in force should be expressed as "a gain of a certain percentage a year" or "to reach dollar level of insurance in force by a specified date" rather than "to increase substantially the insurance in force." Where goals are expressed in absolute amounts, attainment of the goal can usually be determined from the company's financial statement, and satisfactory progress toward the goal may be determined by comparing the corresponding item in the company's financial statement with the projection on which the plan was based. Whenever a goal is expressed as a share of market, or by comparison with industry averages, it is desirable to check progress each time the necessary company and industry statistics are available.

The actuary's role here is to produce the interim standing of the company, whenever the item on which the goal is based is not regularly contained in the company's financial report. In most cases, when an item is important enough to have a goal set concerning it, it either appears regularly in the company's statement or is regularly computed for some other purpose, such as rate-making or determining dividend scales.

The projections used in long-term planning at my company were designed to test the effect of various amounts of new business on (1) business in force, (2) assets, (3) earnings, (4) surplus, and (5) adjusted earnings.

The same computer program can be used to test the effect of other items, such as policyholder persistency and expense rates on the items enumerated.

In conclusion, I believe the actuary has a significant role to play in corporate planning in an insurance company. The company's planning will suffer if he does not do his part.

MR. MORRISON H. BEACH: It has been said that if you have no plan any road will get you there. In any business, after a year has been completed, it is possible to look at results and rationalize that what you did was exactly what you intended to do.

About seven years ago Travelers' top management decided that it wanted to have available a continually updated road map for our operations that would summarize our corporate plans and goals for at least five years into the future. It was increasingly apparent that, as a multiple line insurance company, tremendous advantages would accrue to us if we made advance evaluations of potential changes affecting us—whether they be demographic, economic, political, or sociological. Our company's marketing objective is to serve the financial and insurance needs of the nation's families and businesses. To maintain our share of this market, we must make sure that our capital and surplus funds keep pace with our expanding marketing opportunities; this in turn requires that our insurance operations produce an attractive rate of return on our stockholders' capital and surplus funds. To this end, our most important planning objective is the full and profitable utilization of our human and capital resources. I would like to discuss the types of projections which we use to make sure this management objective is realized.

Our planning process makes use of five separate projections: (1) a projection of the growth of the premium income for the industry for the principal insurance lines; (2) a projection of our agency forces and their capacity to grow and to produce business; (3) a financial projection in the form of profit and loss statements for each of the next five years; (4) a projection of our manpower; and (5) a cash-flow projection.

*Dimensions of the Insurance Markets*

Peter Drucker has said that the main job of business is to create customers. Our projections of the growth of the insurance markets, therefore, start with a look at our potential customers, both present and future—their incomes, their wants, and their insurance and investment needs. Using available demographic and economic statistics, we estimate their needs for insurance protection of various kinds and project therefrom the premium income of the insurance industry. An important part of this process is our speculation on a wide range of developments which can have a serious impact, either favorable or unfavorable, on our marketing opportunities.

*Agency Projections*

Our agency people frequently get quite disturbed when economic projections are used to indicate the future growth of the insurance market. They fear the *implication* that the growth of the insurance industry is *automatically* tied to the growth of the economy. We know that the American public is underinsured, particularly for long-term disability and retirement benefits. The amount of life insurance which will be sold five or ten years hence is to a very high degree controllable; it depends upon the total agency resources which the life insurance industry will bring to bear in developing new agents and increasing the effectiveness of established agents. We believe that this agency growth is one of the most critical problems the insurance industry faces today. Our company's ability to recruit and train new agents and to retain and increase the productivity of established agents is perhaps the most important element in our planning process. A projection of our capabilities in this area is the basis of establishing our premium goals for the future.

We prepare three alternative agency-development plans representing a range of levels of investment in agency expansion. These, of course, must take into consideration the supervisory capacities of our agency staff. The levels of premium income which each of these plans should produce depend on the kinds of agents that we expect to attract and the mix of the insurance and financial-service needs of their clients. We naturally try to direct our efforts to markets and lines which appear to offer long-term profit opportunities.

*Financial Projections*

One of the most useful tools in our planning process is a financial projection using simulation techniques which enable us to prepare profit and loss statements for each of the next five years. The projections are carried out on the basis of assumptions arising for the most part from the Travelers own experience. The expense assumptions are on the same basis as those used in our premium-rate structure.

Throughout the entire process, the projections of business already in force are kept separate from the projections of new business to be written in the future.

Since the projections are to be used for financial analysis, they are developed on a calendar-year basis. The major items produced through our computer system follow:

1. Number of policies and volume of insurance in force
2. Gross premiums
3. Mean reserves at year end
4. The various types of claims and benefits by number and amount
5. Commissions
6. The expense dollars available from gross premium income
7. Taxes (excluding federal income tax)
8. Investment income using alternative investment yield assumptions
9. Federal income taxes
10. After-tax profits

We prepare three projections, referred to as "Most Probable," "Optimistic," and "Conservative."

*Manpower Requirements*

As an aid in planning our manpower requirements over the next few years, each department is furnished with an analysis of the tentative premium goals and other data from the simulation projection. These data are used as the basis for developing projections of the size and type of staff necessary to sell and service our business. As a part of the development of these manpower requirements, salary budgets are prepared using a number of alternative salary projections and levels of turnover rates.

The development of these manpower plans is under the direction of a high-level group of individuals in the company who also have the responsibility for all our career-development activities, such as management conferences.

*Cash Flow*

The final projection that we use is the cash flow. This is merely a rearrangement of our simulation mathematical model. Its principal use is to provide our investment people with a reasonably accurate measurement of the flow of funds for investment, thereby enabling them to do advance planning of our investment program.

*Use of These Projections*

These projections are prepared under the direction of our three profit centers. After all, they have the responsibility for implementing the plans finally approved.

The projections are merely tools which help management decide how fast it wants to grow and in what direction. They do this by illustrating the impact of profits on any growth pattern. They can illustrate the effect of reducing rates to accelerate growth, of improving persistency, of changing the mix of business, and of many other alternatives.

This approach—attempting to quantify the marketing opportunities and distribution requirements and illustrating alternative financial results—has wide application. For example, we used this process in arriving at our decision to develop a computerized hospital-information system in collaboration with the Institute of Living in Hartford. The system will include not only hospital-administration data but will follow the progress of patients by computerizing "nursing notes."

We view our approach to planning primarily as a management technique. It is a means whereby each of our divisions makes a commitment to our top management with regard to its objectives in sufficient detail so that its performance can be measured against objectives. Although these commitments are volunteered, the industry projections serve as bench marks to indicate what our top management has in mind for its growth objectives. The final test, however, is whether the plans do represent a full utilization of our staff and capital resources and whether they will provide a reasonable rate of return on our surplus funds. These objectives and these plans are presented to our board of directors annually.

If planning is to be meaningful, performance must be measured against plans. Our monthly financial statements are prepared on the same format as our planning projections, so the comparison is direct.

The year 1967 was the fifth year of our first five-year plan, and for most areas our results were on target to an amazing degree. I do believe that our performance was better because each department had before it a five-year goal and a commitment which they had made to our board of directors. In one or two areas our objectives were not achieved—and missed by a wide margin—but we will continue to apply our planning procedures. We who have planning responsibilities have to agree with Thoreau, who said, "In the long run men hit only what they aim at; therefore, though they should fail immediately they had better aim at something high."

CHAIRMAN J. CRAIG DAVIDSON: All the speakers have referred to the technique of planning. Planning, I think, is itself a discipline. Plans never turn out exactly as one proposes, but this process or discipline of thinking about the future and determining what the problems are places one in a position where he can tackle the problems realistically and solve them.

We all know that most businesses which fail do so because management does not recognize the problems ahead. This is a most important aspect of the corporate or long-range planning process. It is even more essential for an insurance company to do such planning than it is for most industries because of the long-term nature of our business and also because our normal statements do not accurately reflect our earnings in any particular year.

The actuary has a key role to play in setting objectives, but it is very easy to fall into the trap of having an expansive array of objectives and not identifying the one or two that I might describe as prime objectives. When one has decided what the prime objectives are, he realizes that there is need for a whole series of other objectives or supporting objectives in order to realize the primary or corporate ones.

There is no question that a prime role of the actuary, as has been pointed out by several of the panelists, is to translate plans of action into attaining objectives. Very little can be done successfully in this area, in my opinion, without the necessary sophistication and computer knowledge to construct proper models in order to project into the future.

Just a further comment on the question of organization. How do you organize for corporate planning? It is very essential that the corporate-planning group be free of the influence of the various functions within the company; otherwise the group will be inhibited from looking objectively at the total company picture. In order to do this successfully, we unquestionably need personnel with strong economic backgrounds.

I might say on the role of the actuary that a highly skilled technical actuary obviously has a key part to play in this planning process but by no means is it a total part. However, those actuaries who broaden their knowledge and views of other aspects and other disciplines are in a unique position to make sure that the corporate-planning process is successful. Somebody must initiate these concepts, and a broadened actuary is probably as well equipped as anyone in a company to do this, whether the company be large or small.

MR. WILLIAM C. HSIAO: In your long-range objectives, how much cognizance do you take of changes in governmental policy with respect to the monetary situation, the social security legislation, and taxes? If you do take those things into account, how do you forecast these factors?

MR. JACKSON: I think this is something that is more crucial to the larger companies, because action of government affects the economy as a whole and the large companies would be more sensitive to the growth of the economy. The smaller companies have more opportunity to grow within the economy.

In our own case we assumed merely that the present economic situation would continue in much the same line as it had been going in recent years.

MR. BRAGG: This is not a very easy question to answer. We have not paid enough attention, historically, to governmental actions in our corporate planning. The health insurance corporate planners have been much disturbed over this very thing, seeing their market being apparently taken away by government. We have seen the health insurance corporate planners do some interesting things lately by way of co-operating with government. In fact, there seem to be a much greater acceptance of social welfare and social security systems and the feeling that we should co-ordinate with them.

CHAIRMAN DAVIDSON: In my own company we generally do most of our planning for the future on what might be described as a most-probable approach. We do recognize, though, that there are various areas in which the government is planning further encroachment. This has led us to look very carefully at how we should expand in alternate directions, particularly in the group field. This applies primarily to certain aspects of the health business that are under immediate attack.

MR. WILLIAM J. TAYLOR: Mr. Beach described the Travelers long-range planning as being updated annually, which provides a moving, long-range plan toward an objective five years into the future. Can you contrast this with the fixed-year plan?

MR. BEACH: I will try. The approach that we use is a moving approach, as the question indicates. I think that, when you try to make long-range planning an important part of your management process, you must make sure that it does not become straitjacketed. Our first-year plan was adopted and approved in 1962 and covered the period through 1967. Each year since 1962 we have taken into consideration the various developments which have occurred and have revised the plan accordingly. I think it is rather interesting that the targets we set under our plan in 1962 in relation to performance in 1967 were just about as close as the revisions of the plan.

We now have a reporting process. It is a new technique to provide our management with a quick look at what was said about 1967 goals in 1962, what was said about our goals in 1968, and so forth. That gives them a moving picture of how the targets are changing.

MR. MICHAEL ROSENFELDER: Mr. Bragg, I believe that in your comments you stated that proper planning should be directed toward the total marketing concept. I wonder if you would care to elaborate on this statement?

MR. BRAGG: The total marketing concept basically is a matter of getting across to the field and to the home office the message that what the company is interested in doing is increasing the number of sales interviews that take place and the success rate on those sales interviews. The idea is to permeate the whole company with this philosophy. I will elaborate on what it means specifically.

The agency system seems to be in fairly poor shape. The reason for this is that not enough prospects are being found. The agents are very good at selling when they have a prospect. The breakdown is in finding the prospects, qualifying them, and persuading them to be interviewed. I think that the total marketing concept might involve the company's taking over the responsibility for those things to some degree. It also involves a very extensive study in terms of where the good buyers are geographically, what their characteristics are, and so on. It could involve the use of computers to keep lists of prospects, to prequalify them, to preinspect them, maybe even to preunderwrite them to some extent.

MR. GEORGE RYRIE: There is an idea of the total marketing concept which is much broader than has been stated. It is the idea that everybody in the organization has something to do or can have something to do with putting business on the books and keeping it there. Even the accountant should have some idea of the work he is doing in helping policyholders to pay premiums. I am wondering whether the total marketing concept is normally confined to the planning group, or can conscious steps be made to acquaint a whole group of people with this idea?

MR. BRAGG: What we are trying to discuss here is what should be done, not what actually is being done. But I do not know that my ideas of the total marketing concept really differ from yours very much. I am merely trying to make it a little more specific, that's all, rather than presenting it in terms of generalities.

CHAIRMAN DAVIDSON: I wonder if I might add a comment on this particular subject. We went through a major reorganization in the company about two and a half years ago, and one of our prime concerns was to orient every staff member to the idea that he is contributing to this marketing concept. One of the major considerations in the reorganization was to bring together under one person all those functions that you might say bear directly on the market and our customers. This person thus has the necessary groups of people to work with to increase the market orientation.

We also prepared a filmstrip with a sound track. It shows an encounter between one of our field representatives and a girl who works in the home-office underwriting department. As they carry on a dialogue, she gradually realizes the importance of the work that she is doing in helping the man in the field do his job, and vice versa. We show this to all our new staff members when they have been there a reasonable length of time. It is through means such as this that you gradually infiltrate the so-called isolated groups in the home office so that they feel they are a part of a total marketing organization.

MR. MELVIN L. GOLD: Certainly corporate planning is important for the medium-sized and large company, but in many ways it is even more important for the newer company where their very existence may be on the line. I have found that most of the smaller companies do not do any planning except to express a desire to write more business and to make more profit, or some other vague generalities, with the president dominating the whole situation. I have been able to prevail upon our clients to have a session in the spring after the annual statement has been completed at which I discuss with top management where the company is going. This is one area in which I feel that we consultants can serve a most important function.

MR. DONALD M. ELLIS: Mr. Jackson stated that the man who headed up a department would not have to be an actuary. This would be good news for some of us who do not have enough actuaries to handle the various things that we would like to see done. I wonder if he would state whether his company has used someone other than an actuary to head up planning and, if so, whether he was successful? What kind of individual was he? What were his background and training?

MR. JACKSON: The essential characteristics of such a person would be a broad knowledge of the industry; broad knowledge of the company; intensive training in many phases of the company's operations; and creativeness, imagination, and diplomacy in dealing with people and with other departments.

With regard to our own company, I did not base that observation on the way we are operating. We are a relatively small company; to give you an idea of our size, we have less than two hundred home-office employees. In our own case our corporate planning has been directed by our president who is himself an actuary. I based my observations on the LOMA Long-Range Financial Planning Committee. More than 50 per cent of the members of that committee are not actuaries but seem to be very well informed and capable on life insurance planning.

MR. PETER R. WILDE: I would be very interested in whether or not the mutual fund is viewed as an additional profit center at the Travelers.

MR. BEACH: At this point in time we are not establishing a new profit center. We have announced our intention to market a variable annuity and mutual fund. We are not treating them as head-on products. We are trying to integrate the marketing of these products with our regular life insurance.

A number of us on the panel have referred to the fact that one of the toughest problems of the life insurance business is to attract a sufficient number of the kind of agents that we need. We have analyzed our market to determine the needs, or at least the preferences, of our customers, and we think that by adding these equity products our agents can do a better job for their clients. We also think that we will attract more and better agents. Our approach to marketing equity products is so closely related to the sale of life insurance that it is essentially not a separate profit center and I think the same type of commentary could be made with respect to our group operation.

MR. J. STANLEY HILL: We have heard of the rather elaborate simulation or computer models that some companies have to get into the planning business. I believe it is possible to construct a computer model of a life insurance company on a relatively simple scale and still derive considerable value from it.

We have a small forecast program, with only a couple of hundred instructions, which sheds considerable light on what conditions may look like by 1975.

I would like at this time to introduce a distinguished guest—Mr. Murray Grode. Mr. Grode is a key member of the staff of the Life Office Management Association; he covers a great deal of ground in the organization, included in which is corporate planning. Under his leadership a committee put together a very fine manual for corporate planning which we have found very helpful.

MR. MURRAY GRODE: LOMA's Financial Planning and Control Council, through its Annual Profit and Long-Range Financial Planning Committee, has been instrumental in issuing two manuals to date on long-range planning—the first in 1966, *An Introduction to Annual and Long-Range Financial Planning* ("Financial Planning and Control Report No. 5"), and the second in 1967, *Fundamentals of Corporate Planning in a Life Insurance Company* ("Financial Planning and Control Report No. 7"). These reports are available on loan from the LOMA library, or they can be purchased, of course. They have been sent to the principal representatives and presidents of LOMA member companies. The committee is still hard at work on producing follow-up material on considerations involved in, and techniques of, long-range planning, which we are hopeful will result in additional reports in the near future.

MR. RALPH E. EDWARDS: Mr. Jackson mentioned amounts of insurance as a basis for planning. I wonder whether it is practical to use more than one measure, such as bringing in premium volume or number of policies. Further, should you set your objectives in terms of the industry's progress as well as your own goals?

MR. JACKSON: We use insurance in force in our own planning and comparisons insofar as individual life insurance is concerned, but the individual health insurance and group insurance we do plan in terms of premium rather than insurance in force.

We have chosen insurance in force for the individual life because we have based our rate structure on face amount rather than on premium; for this reason we felt that it was a more appropriate base to use in our long-range planning.

MR. NICHOLAS BAUER: I would like to ask the following questions: Does any company follow a procedure whereby the objectives set up by the planning committee are subdivided and handed all the way down the line to the intermediate and lower echelons of supervisors in the agency force so that each segment of the company can acquire a real appreciation of how it is supposed to fit into the picture and what production is expected of it? If so, are these objectives inflated slightly over and above what the central planning group might think reasonable so as to provide added incentive?

CHAIRMAN DAVIDSON: We find that in certain areas of the company we have basic corporate objectives which we define as growth on a sound financial basis. In the individual line we have one person that is responsible or accountable for attaining the individual growth objective. He has under him four people who are identified with the four major geographic areas in which we operate. Each one of them takes, as far as growth is concerned, his appropriate share of the total growth objective.

In Canada we have seven superintendents, each of whom has a specified geographic area to supervise and is required to make his contribution toward the attainment of the Canadian objectives.

You really get into a major problem, though, in subdividing the objectives when you get to the so-called service departments. About all that we have been able to accomplish is to assign to the service departments at least a contribution curve to an expense rate production program. There are so many service departments, however, which cannot control the volume of their work.

MR. HILL: I wish to comment further on the subdivision of goals in the service area. This is done in our company through what we call "profit center expense control"; probably, to be more accurate, it should be called "cost center expense control," which really amounts to providing a very detailed functional cost analysis as a part of the regular budgeting and expense-control procedure.

For example, when the manager of the individual policy service division prepares his budget, he prepares not only a list of the so-called ledger expenses but also estimates the charges which will be made to him by personnel, supply, printing, and so forth, for the services they render for him. He will add all of these up, proceed to distribute them among the twenty-nine different functions that he performs, and thereby produce a unit cost for changing the beneficiary, making a cash loan, making a cash receipt, and so on. This way we can give him rather specific objectives in terms of aiming at controlling the unit cost on a personalized thing at a very effective level.

*Los Angeles Regional Meeting*

CHAIRMAN WILLIAM H. BREEZE: Corporate planning promises to become an increasingly significant part of our business lives. Mr. Richard F. Neuschel, of McKinsey and Company, stated at the A.L.C. Executive Round Table earlier this year that corporate planning in a life insurance company is particularly difficult for the following five reasons:

1. It is difficult to measure performance because there is no accepted yardstick for doing this well. Sales volume, insurance in force, premium income, and net gain have been used frequently as statistical measures of how well a company is doing, but these are not really satisfactory yardsticks by which to measure performance. Further, the life insurance business involves a long time lag between the activities that must be performed today to achieve desired results.
2. There is seemingly a limitless life insurance market. As a result there has been a general tendency for companies to accept without question traditional approaches to doing business.
3. Competition for products has been very limited because of the ease of copying other companies' products.
4. People's advance in life insurance corporations has been dependent to a large degree on technical knowledge rather than managerial ability.
5. There is a lack of strong pressure from shareholders.

What is the value of corporate planning? In my view one major value may be the survival of companies in the increasingly competitive environment of the next few years.

Other important values to be derived from effective corporate planning include greater productivity of people stimulated by the effect of an achievement environment and a growth atmosphere and the ability to build and attract better people.

As actuaries serving a business that is as much future-oriented as it is present-oriented, we possess many of the tools much needed for our companies to become more effective planners. One of the two most important elements of a plan is the objective—what is to be accomplished. The other, equally important and equally difficult, part of planning is the action program—how it is to be done.

MR. LOUIS GARFIN: My view of corporate planning is that it involves the setting of goals and the adopting of a strategy that seeks a balance between the desirable and the possible based on educated judgment. At Pacific Mutual Life, as a first step toward determining or establishing a definition of the desirable, we adopted the following statement of corporate purpose:

> To assist the public in the achievement of private financial independence through the marketing of quality life, health and retirement insurance and related services at the lowest cost compatible with financial soundness and fair compensation to agents and employees for quality service.

One part of the actuary's role, I think, is to help translate such broad general objectives into more specific objectives that can help to determine courses of action. For example, in the major objective, quality products are mentioned. This immediately involves the actuary in questions of product design, product mix, and consideration of such new fields of activity as variable annuities, mutual funds, and so on.

In the second part of planning, determining the possible, the actuary will find a major role in determining measures of performance and means of making comparisons, so that company management can see where it has been and where it is planning to go.

In our company, through the co-operative efforts of the actuaries, a management consultant, and top management, we worked out a measure of performance based on the growth in assets and the contributions to dividends. This standard of performance, which we designated "CDA," has a number of useful characteristics. It is sensitive to the activities of the company, both insurance and investment. It can be determined fairly readily as the net of incurred income less outgo, except for dividends and reserve increases, so that it is in a way related to the current gains from operations. It can be determined historically, and, with some limitations, it can be determined for competing companies. It can be determined for each line of business, and, if so used, it may be a tool for setting goals and measuring performance by line of business.

We recognize that this measure has some imperfections and that there is a need for other controls. For example, performance by this standard could be artificially improved by selling a large volume of annuities at inadequate rates, thereby increasing assets rapidly but leading eventually to losses to the company. Other methods might be devised to improve performance by this standard by taking actions actually unfavorable to company improvement. However, we decided to use this measure because the advantages on balance outweigh the disadvantages, recognizing, however, that other controls must be set up to preclude our taking any of these grossly unfavorable actions.

Having decided on this measure of performance, we set some very long-range goals in terms of growth in this measure, CDA. We determined these by comparisons with a selected group of companies that we thought had done reasonably well over the past ten years. We then prepared detailed projections for five years into the future and finally produced even more detailed projections for the next year.

In preparing all these projections, actuaries were involved in many areas. We started with total premiums. Then we had to make translations from total premiums to the implied new production that was required so that premiums would grow as projected. Working from that, we projected the manpower requirements to obtain the required sales and other requirements of agents.

We had to work closely with our investment experts to determine what investment income would be, and we had to work with our sales-management organization to set up a system of performance controls in terms of numbers of agents hired, retention of agents, and other matters.

MR. ALFRED L. BUCKMAN: Actuaries who are concerned with corporate problems help management to determine (1) what lines of business the company should offer, that is, ordinary, group, industrial, accident and health, hospitalization, major medical, variable annuities, mutual funds, credit insurance, and so forth; (2) what types of sales organizations to use, that is, general agencies, branch offices, direct writing; (3) tax planning; (4) when and what companies or block of business should be acquired or sold; (5) retention limits and what reinsurance contracts are necessary; (6) annual budgets; (7) choice of data-processing equipment; and a host of other major decisions that must be made by the modern insurance company.

If an actuary is associated with a company that is acquisition-oriented, he becomes deeply involved in evaluating other companies and helps to find formulas and methods by which sales and acquisitions of companies or blocks of business can be made to satisfy both buyer and seller.

In the current trend toward development of holding companies, the actuary may have a major role in determining the appropriate stock exchanges for shareholders.

In the problem of acquisition of insurance companies, there is generally involved an exchange of stock between buyer and seller. This requires the evaluation of the relative value of the business of the two companies and the translation of this into relative values of a share of stock of each company. In this determination the growth potential, agency force, home-office staff, geographical location, and nature of the products of the company are all important factors in determining its over-all value to the parent company. The actuary, of necessity, is the company official best equipped to place values on these factors.

In my company, Beneficial Standard, we have pioneered in developing a new marketing technique that involves the selling of low-premium products to holders of credit cards and the use of the credit-card facility to bill and collect premiums. The company has been quite successful in developing these plans.

In considerable measure this success is a result of the use of control devices designed by the actuarial staff. Loss ratios, marketing expenses, percentage returns, costs of servicing the business, and cash-flow estimates are projected for each product, and results are carefully and continually studied to see how closely they follow the projections. Successful programs are repeated periodically. Unsuccessful ones are revised or discarded.

When a new solicitation is made for one of these programs, we keep daily records of returns. Over the past we have been able to develop a table showing for a given number of days that the enrollment has been in effect the percentage of the ultimate enrollment expected to be achieved. For example, we know that, in the first four days after the date on which the first returns are received, we will receive about one-quarter of the total that we can expect to receive for the entire enrollment period. With this special control device we can determine at an early date whether a new insurance program of this kind will be successful, and we can plan for the volume of work that will flow through our underwriting and issue department at peak periods.

MR. JOHN D. MACPHAIL: The planning process involves a very substantial amount of forecasting or projecting of the future, in our business in particular. This, of course, is nothing new to actuaries. However, the techniques of projection and simulation are an essential part of the planning efforts of a life insurance company. Improvements in computers in recent years are such that we now have the capability of simulating operations with fairly detailed models.

When we look toward the future, it is important that we give some special thought to what we are going to forecast; what are the real essentials? I think that the actuary, by his training and experience, should be valuable in determining the answer to this question. He should be in an excellent position to define the control units that are important to the company's operations. In making forecasts, we want to concentrate on future needs of the company for resources and on how we are going to use those resources.

The resources that I would recommend concentrating on would be the knowledge and capabilities of your staff, time requirements, and, of course, financial items. To date, most of the models we have used have dealt with forecasting financial operations. In the future I think these should be expanded to forecast manpower and time needs as well. Having determined that these are the future needs that we want to forecast, we need a means of doing so.

Many consulting firms have excellent techniques for making financial forecasts. They have some advantage in this in that they perform this service for several companies and can share the cost of development of procedures among several client companies. A common tool now being used is the preparation of a product-in-force model with appropriate weighting factors for the plan and age distribution. It is desirable that these models not only be based on the distribution of the amount of insurance but also on other factors, such as the amount of policy reserves. These models can be very useful in the actuarial operations of the company, for example, in the development of suitable gross premiums and sales-compensation plans. Another important use of projections is to establish performance standards by which actual future operations can be compared to planned operations. Expense rates and agents' survival rates are items that can be established readily from projections.

One special advantage to be gained from the use of projections is the management development that comes from doing so. The mere fact of considering future alternatives and the process of determining the major factors that will influence the future and carrying through the projection bring to those doing the work and those reviewing it a much-improved knowledge of the forces affecting the business and how they may influence the future.

Not only should top management be committed, but a favorable attitude toward extensive planning should be sought throughout the organization. If any serious employee resistance develops to an operation of systems planning, the results may be disastrous.

MR. RANDALL M. LUZADER: To what extent is it important that the actuary concern himself with the approval of top management before taking an active role in corporate planning?

MR. BUCKMAN: There are many situations in which it is necessary for the actuary to take an aggressive leadership role to change company plans. Some examples from my own experience can be given.

Shortly after my company started selling credit insurance, in the early 1950's, our actuaries noted the unfavorable public relations deriving from the unusually high premiums that the public was charged for this insurance and vigorously advised management to revise its plans for expansion in this area.

Another example was in the California U.C.D. business. Our actuaries were instrumental in having the company change its plans for growth in this area when it was learned that premium rates were determined on the basis of political considerations rather than on the basis of actuarial expertise.

In still another example, our actuaries took an aggressive leadership position in advising the company to terminate its hospital and medical-surgical business in Canada when government expansion into that field greatly reduced the need for private coverage there.

About ten years ago, after extensive planning, our company went aggressively into group insurance with a complete portfolio of coverages. It soon became obvious that competition for group business was too keen, that the operation of an aggressive group department was too costly, and that thirty or forty proposals had to be made for every case closed. After less than two years in the field, the actuaries recommended that the company cease its aggressive, competitive activities in group insurance and retrench to servicing only that business in which our full-time agents had a good measure of control.

In these kinds of situations the actuary must move aggressively and independently as a part of top management without waiting for impetus from other sources.

CHAIRMAN BREEZE: Close liaison with top management is necessary, and it is certainly important to have top management's commitment to any program of planning.

MR. GARFIN: In addition to being committed, it is important that management and others in the organization have a reasonable understanding of the fact that planning is a time-consuming activity and that they should be prepared to staff for it and make available the people who will be required to carry it through.

Actuaries must be involved to a great degree in the orienting of top management and other personnel with regard to some of the planning activities. In our operation the CDA yardstick is a technical one, and actuaries have been called upon to explain this to senior management, middle management, and to supervisory employees, so that all will know about this measure and its use in laying future plans.

MR. BERNARD RABINOWITZ: In connection with the actuary's relationship to top management, it would be my view that the actuary should be a part of top management and that the training of the actuary should include managerial skills.

I agree with Mr. Garfin's recommendation that the increase in assets be one of the measures of performance of a company. I think this is particularly true for a stock company writing mainly nonpar life business where investment income contributes substantially to profit.

It seems to me that another area in which the actuary can be of service is in investment management. He can tell the investment department what sort of investments are needed in regard to existing business in force, scheduling out the maturities of those investments so that, together with expected premium and interest income, they will match each year the expected payout of insurance proceeds and expenses. This matched position, however, minimizes profits as well as losses, but it does provide a standard against which investment opportunities may be assessed.

The actuary might also advise his company about investments so as to offset the inflationary aspects of insurance administrative costs. For example, he might feel that a certain policy toward investment in equities might serve to offset the rising cost of administration of insurance policies in the future.

MR. GARFIN: I agree generally with your suggestion that we should be more closely involved in the investment policy and investment activities. In many companies, however, I believe that investment people would have greater expertise in the quality, availability, and types of investments than the actuaries. In our company we work with them in terms of available funds, tax consequences, and in some other aspects in which we have somewhat more direct and precise information.

MR. BUCKMAN: I agree wholeheartedly with Mr. Rabinowitz, that actuaries should be management and not merely report to management. This is not always possible, however, especially when a new company is involved. When a new company is getting started, the actuary is not the motivating force. Usually an investment company starts the operation, and in the early years the sales and investment departments are both dominant forces in the operation of the company. In older companies it is true that actuaries take a more dominant role in management. This is evidenced by the increasing number of actuaries who are becoming presidents and executive vice-presidents of large, well-established companies.

MR. LAWRENCE MITCHELL: In my opinion an actuary is not really an actuary unless he is a part of management. This is true even of the consulting actuary, since in his relationship with his client company he is often asked such questions as, "What should we do?" or "How should we activate this program?" In answering these kinds of questions, the consultant does actually become "management."