

**RECORD OF SOCIETY OF ACTUARIES
1993 VOL. 19 NO. 4A**

SENIOR EXECUTIVE OFFICER FORUM

Moderator: CHARLES R. HASKINS
Panelists: JOSEPH T. BROPHY
ROBERT L. COLLETT
JOHN H. HARDING
DAVID M. HOLLAND
Recorder: JONATHAN ROSENBLITH

Senior insurance executives will discuss current management issues and the responses taken or contemplated by their organizations followed by a free-flowing question and answer period. Topics will include:

- Issues facing a transformed industry
 - Image of industry
 - Technology
 - Complex competitive environment
 - Expense and profitability problems
 - Expansion of government programs
- Strategies and their implications to actuaries
 - Positioning for potential health insurance reform
 - Maximizing profitable use of information technology
 - Downsizing, outsourcing and lean staff
 - Product focusing and niche marketing
 - Joint ventures versus mergers
 - Improving the image of the industry
 - Managing employee relations in a climate of change
 - Motivation and empowerment of employees

MR. CHARLES R. HASKINS: In this session, senior insurance executives will discuss current management issues and the responses taken or contemplated by their organizations. Jon Rosenblith is our recorder. We are both members of the Society of Actuaries Committee on Management and Personal Development. Our charge is to encourage the development of the management skills of our Society members. Our four distinguished actuarial managers will be outlining issues faced by their organizations. These have been broadly grouped into five categories: image of the industry, technology, complex competitive environment, expense and profitability control, and expansion of government programs. We all know the issues. We face them every day in our work. The goal of this session is to provide expertise, answers and solutions to these issues. The executives on this panel have grouped solutions into eight broad areas: positioning, maximizing technology, downsizing and outsourcing, niche marketing, joint ventures, improving our image, employee relations, and motivation.

We have four distinguished senior executive officers to address us. Joe Brophy is a consultant with Actuarial Science Associates and a past president of Travelers Insurance Company. He brings to us his experiences from a megacorporate perspective. Bob Collett is president and CEO of Millman & Robertson. His focus is on management solutions that his organization has employed with clients throughout the industry. John Harding is president and CEO of National Life and manages a large and growing insurance organization. He will share with us his experiences in directing

this growth while addressing expense and solvency risk-issues. Dave Holland is president and CEO of Munich American Reassurance. He not only must address management issues faced by a service organization, but as a reinsurer, he is in partnership with his clients. He brings to us his perspective as a risk-sharing consultant.

Our first presenter is John Harding. John joined National Life in 1962 after actuarial student work at New York Life and receiving a degree from Princeton. He rose through the ranks to become senior vice president and chief actuary in 1980 and president and CEO in 1987. John is the current president of the American Academy of Actuaries, and a member of the board of directors of the Society of Actuaries. Since 1977, he has served on a number of Society committees including the chairmanship of the Insurance Solvency Task Force. In his spare time he serves on the Green Mountain Executive Council of the Boy Scouts of America and on the Board of Directors for the Vermont Philharmonic Orchestra.

MR. JOHN H. HARDING: My focus is predominantly on what I see in the life industry, but I think that many of the things that I will mention probably have an impact anywhere within the financial services industry. I decided that it would be better to try to be a little bit more free form to outline some concepts with the hope of discussion later.

Since the mid-1980s, more financial products are offered by a broader range of financial institutions to a much narrower customer base. There's been downward pressure on the resources available to our customers. There were high expectations during the 1980s for product performance that have clearly dimmed, followed by disillusionment of both our customers and to a great extent some of our distribution channels. Our customers have responded by taking a much harder look at the financial products they buy and from whom they buy them. Companies have responded by adopting a new customer focus, a change from product focus to a market focus. What do our customers really want from us and how do we deliver to meet customer expectations? Those are the new things that we are learning to ask. But, historically, we've been a product-driven industry for so long that the change in mind set is slow, and not anywhere near complete. As I look around, most marketing approaches that I see are sales tracks with product designs that start with a premise that we'll sell to those whose perceived financial needs can be gerrymandered to fit the products we manufacture. We have focused on product first, need second, and customer third. I suggest that those priorities are backwards. Instead of searching for customers that might buy what we produce, we must look very carefully at specific market segments and identify the types of needs we can fill through relevant distribution channels. We must use the appropriate array of skills that we have to offer and put them behind the products we create in that context.

The enjoyable part of this kind of market response is the product's focus and the new strategy. The tougher parts include the downsizing, joint ventures and mergers, which often in themselves cause further downsizing. As I explore the concepts of downsizing, joint ventures, mergers, and the other issues, I'd like to do so in the context of an example of the new strategy. Dr. Gary Hamel (Professor, Strategic and International Management, London Business School, London, England) made some interesting points at the General Session. I would particularly like to reinforce three of

SENIOR EXECUTIVE OFFICER FORUM

them here. When you look at a return on investment (ROI) or whatever your measure is, an awful lot of the attempts have been really to reduce the investment element or the denominator, and in fact, the only way you can be functional long term is to increase the numerator. I think the thing that we have to do is identify our key competitive competencies and build on them, and to focus our efforts on a specific future direction.

Let's do that in the context of a hypothetical market-niche approach that I'll use as an example. It's not the one I personally use. I want to use lawyers in private practice. Let's suppose we devote our entire company's efforts to servicing that marketplace. Now that's a useful example and one that is rife with lots of jokes.

Let's start with strategy and organization. The primary function of marketing will become one that creates a corporate image as the best insurance company for lawyers when they're dealing with financially related issues. And the company understands their financial and business problems better than any other company around. Lawyers slowly begin to know that and slowly begin to recognize that your distribution system is one that, in effect, can serve that marketplace in that way.

Market research then becomes a critical tool for both marketing and product development. Ultimately, even the composition of the board of directors probably changes. Agents are recruited and trained specifically because of their ability to deal with the marketplace of the lawyers in private practice. All product development decisions and all decisions concerning what products should be delivered would be made in the context of serving that market. Policy terms would begin to focus on the characteristics of that market segment. For example, in disability income, you would begin to have coverage provisions that specifically apply to lawyers – specific exclusions or inclusions regarding laryngitis or ambulance chaser's knee. Strong consideration would be given to providing structured settlement products and perhaps the provision of expert witnesses within the layers of expertise that would be available to and through the company.

Does this kind of a focus mean that the company would only sell to lawyers? Of course not. What it does mean is that you don't spend a lot of resources chasing other markets. Every decision you make is focused on what it means to this marketplace that you choose to serve. The reason I think this is important is that an awful lot of our corporate expenses in any company come from chasing the fringe areas and chasing the things that are peripheral to a corporate focus, particularly if that focus is not clearly defined.

The process of downsizing and culling unnecessary function can be much better done in the natural context of your company's focus – where you're trying to take it, and what you can leave behind. My company has shifted to a market focus and I'd say that in the conceptual transition, we're probably two-thirds of the way there. Every once in a while I've got to read out somebody for forgetting what kind of a company they're now in. But we've reduced staff by 40% in the last five years. At the same time, we've increased the relevant functionality. There are times, as I look back, that I'm not sure what that other 40% was doing. The hard questions are better answered in the context of the clearly understood corporate focus. This doesn't mean that downsizing won't be hard and the human dislocations won't cause pain every

day. But just as the decisions can be made more readily in that context, so can the acceptance of the people displaced because there will be a better understanding and a better answer to the question, why me? Let's shift to joint ventures now and mergers in the context of corporate focus.

Mergers become much more of a problem because not only are there normal differences in corporate culture to overcome, but the possible congruence of corporate focus is much less likely. On the other hand, joint ventures can be simpler because joint venture partners are less likely to be in direct competition. However, joint ventures are not easy either. While joint ventures are not as intrusive as a merger which changes the working relationships of most of the people in both companies, even minor differences in corporate culture among joint venture partners need to be anticipated and dealt with in the context of the joint venture.

What may be an obvious and unquestioned method of doing business in one company can cause significant trouble for the other. For example, my company and UNUM produced a joint venture disability product to be sold through my company's career agency force. We previously had a very competitive, highly loss-prone disability portfolio. UNUM is predominantly in the brokerage business and also has a very effective product portfolio and specific ways of managing that portfolio. We had to work through a myriad of issues to resolve potential conflicts in the distribution channels. The home-office mind sets had to be questioned and modified in both companies before we could make it work.

I'm reasonably pleased with what we anticipated before the joint venture began, but I'm surprised at the ones we missed. Top management had to continually work to resolve cross-cultural issues for many months after the first roll out of the joint venture. We still meet periodically to make sure that the organizational and cultural barriers are not inhibiting the success of that venture. While clearly not the case in the joint venture example that I've just used, I believe that successful joint ventures of similarly focused companies can be made to evolve into a rather painless merger over time. In fact, if we need to reduce the number of companies in the insurance industry (and I think we do), the evolutionary method of merger through joint venture may become a very efficient way if there are not heavy time constraints.

I'd like to shift now to the fifth topic – insurer solvency and solvency management. I've chaired the Task Force on Insurer Solvency ever since it was founded in late 1991. Dave Holland has been on that task force and has been tremendously helpful to me. There are many issues of concern to actuaries in the solutions that we propose. Right now I'd like to focus specifically on those related to management issues rather than technical issues. Our central premise is that the actuary is in a unique position to provide substantial value to management in dealing with the solvency risk.

Last year I had a conversation with an actuary who is the chief executive of a well-known life insurance company, and I was delighted with the thrust of his concerns. His primary concern was that what we were suggesting would usurp his role. As the leader of his company, he had always felt it essential to continue to review with his board the on- and off-balance sheet risks that he saw the company exposed to. He would quantify those risks or have them quantified. He saw no added value to the

SENIOR EXECUTIVE OFFICER FORUM

actuarial report. I asked him several questions that demonstrated that in fact he was orchestrating within his own company precisely what we were suggesting, except that he was taking that role as CEO rather than as chief actuary. I asked him if his successor would be chosen on the basis of being able to fulfill that role. The answer was no. I asked him how many companies he knew of where the chief executive was performing a similar role. He said there were very few. Finally, I asked whether this role should be performed in all companies, and the answer was, yes.

I would contend that while the actuarial profession will not have all the expertise to do the entire job, it is the best profession to oversee the job and make sure that it's done and done well. If we could be assured that the job could be done in all companies simply because the technology and standards were available, we wouldn't need any regulatory overlay. But precisely where the function will be needed is most likely where it will not be performed, unless there is some form of regulatory compulsion behind it. That compulsion must have, as its main property, the fostering of the appropriate management of the solvency risk, within the company, rather than through outside sources.

I hope that this has raised some issues that we can discuss after the other panelists have concluded.

MR. HASKINS: *Our second presenter is Bob Collett. Bob is president and CEO of Milliman & Robertson, Inc. (M&R) and has special expertise in life and health insurance. Bob began his actuarial career with M&R in its Philadelphia office in 1966, then opened its first Southwestern office in Houston in 1970. Bob assumed the presidency of M&R in 1990 and became CEO in 1992. He has been active in the International Association of Consulting Actuaries and is currently first chairperson of the International Section of the Society of Actuaries. He is past president of the Actuaries Club of the Southwest.*

MR. ROBERT L. COLLETT: *I'm going to be discussing four topics: positioning for health care reform, maximizing the profitable use of information technology, managing employee relations, and empowerment through profit centers.*

The first topic I want to talk about is health care reform. Calling this topic health care reform is a more accurate statement of what we're in for. I think you've had to decide if you're going to fight what the administration and the Congress will propose, or if you're going to adapt it to something you like better. Eventually you're going to adapt to it. My own view is that it's unrealistic to base one's strategies solely on the first idea. At the same time, I think it does make a lot of sense to try to shape the final result into something that you can live with. Having done your best in that regard, at the end, I think you've got to have strategies for adapting to health care reform.

The question then is, what strategies are you adopting? Broadly speaking, there are only three that I'll talk about. First, if you don't think you can operate in a managed care environment, and if you're not already fairly far along in your thinking on the first idea, then getting out of health care insurance is probably the right strategy for you. The second strategy would be more positive, and that would be to single out a few areas for your own efforts, in line with John Harding's comments to pursue just a

few selected niches for your company. You might elect to be a provider of group health insurance but only in a few geographic areas; you might try to be the fee-for-service alternative; or you might offer supplemental products that make sense and are permitted. The third and most ambitious strategy would be that of going full bore either regionally or nationally. I would say that few of us probably have the capability to seriously consider going national. I'd say that whether you go for a few areas of the country or for many, you still will have the major risk of not making the ultimate lists of those groups that are allowed to do business. The Clinton purchasing cooperatives can cut out providers for reasons of price. Further, a major commitment will be extremely expensive. There's a major investment in tooling up, major surplus needs to go with the risks that you'd be taking on. Very likely a shortage of capital will be the eventuality.

There's one other element that I believe should be a part of any positive thinking strategy. That would be to support the role of the actuarial profession. Both the Society and the Academy have major roles to play and have already created a number of task forces that relate to health care reform. The Health Risk Adjustors Task Force is creating an offset to antiselection. Medical effectiveness is very important for managed care and requires the participation of actuaries, physicians and information systems experts. The task force on solvency for new insuring organizations is critical since these organizations will have the same or greater risks as insurance companies. A task force has been created to address an expanded health care database. Actuaries know commercial experience and a lot about Medicare risks, but there's more they don't know about Medicare risks. They know less about the Medicaid population, and least of all about the uninsured population. So a larger, significantly broader database is needed. Creation of a macroeconomic model adding the other populations to insured data will be very expensive to do. This project hasn't moved too far along but I really think it would be an important undertaking for the profession. We need interdisciplinary activities such as better communications between actuaries and nonactuarial experts. We must talk to one another and share our knowledge.

A second interdisciplinary topic would address the use of information technology. There are many new ideas and new technologies out there. I'll speak to just a few of them that we're directly involved in. A very interesting one for us that we've gotten into in a fairly big way has to do with interactive voice response (IVR). It gives the ability, through the telephone, to accomplish many tasks in a nearly paperless environment. IVR technology can be used to provide information, to provide decision support tools, and to provide transaction capabilities to employees, to clients, and to prospects. So far we and our clients have applied interactive voice response to employee benefit inquiries and plan choices, survey activity purposes, as our health care cost hot line, and in bulletin boards such as job postings, etc.

Another technology item not far removed from IVR, which has become very important to us, is something we call interactive simulations. This is interaction through PCs. We found considerable interest in the use of interactive simulations in a live presentation context where we obtained questions and were to provide immediate answers. We've applied these capabilities to line of business projections, benefit plan cost analyses, and pricing studies. What's required to be involved in interactive simulations? You need to combine model building, a lap-top computer, some

SENIOR EXECUTIVE OFFICER FORUM

projection hardware and creative presentation design work. Care in creative design is necessary, since it's at least as easy to confuse people as it is to enlighten them with pictures, numbers and alterations in a projected image. Interactive simulations are not so much new technical tools as a new way of engaging audiences. We've got some consultants who use these presentation ideas very extensively. These ideas seem particularly well-suited for smaller groups like boards of directors or trustees who need to grasp the consequences of changes in very complex relationships.

Another technological area close to the hearts of all actuaries is actuarial forecast systems. Great strides are being made in PC-based systems. I've seen systems incorporate ideas such as: (1) open architecture, allowing changes in virtually every aspect of the system with little or no degradation in performance; (2) the use of actuarial languages which allow efficient recompiling; and, (3) sophisticated memory management which accommodates a seemingly infinite variety of creative redesigns. These systems are extremely user friendly. Documentation is accessible through the screens. You can get flexible input and output formats and flexible processing cycles monthly, quarterly, and annually. However, learning time is still very significant to take advantage of these features even though they are user friendly in a way we have not seen before.

As a final technology area, I'd like to offer a few words about networks. Local area networks seem to offer most of the advantages associated with mainframes. They allow people to share files and software, specialized hardware such as scanners and color printers, and E-mail bulletin boards. They make available security backup and disaster recovery with less bureaucracy than mainframe shops. And because they're built from PCs, local area networks are incrementally upgradable and less expensive. The rate of evolution in software and hardware is truly phenomenal in the PC environment. This offers a real advantage, because new software seems to be written first for the PCs and then for work stations and mainframes. This PC software is also far more user-friendly than in a mainframe environment. Our experience with wide-area networks to date has been fairly limited. It seems to me that a wide-area network usually involves more file trading and moving of files and less file and program sharing, access, and use. We see for our firm a combination of wide-area networks and local networks as ideal. This provides local computing, file and program trading, and cost sharing of very expensive items such as interactive voice response.

My third topic is managing employee relations. One negative aspect of employee relations is employee disaffection especially at time of departure. John referred to downsizing. You heard about it as well. None of us is immune to downsizing or the temptation of it, but all of the anecdotal evidence that I see or hear these days suggests that employee complaints at time of separation are on the rise. There are allegations of wrongful discharge. There are post-discharge complaints about overtime inadequately compensated. There are allegations of a hostile work environment, age, sex, race or disability discrimination charges, and complaints as to de facto employee contract violation. There is more of this out there than ever before, and I attribute much of it to the downsizing environment that we see.

The problem seems to be threefold. First, I've mentioned economic pressures and the tough job market. If you get laid off, it's not easy to find a new job these days.

Second, I think employee expectations are significantly higher these days. Job for life security is not possible anymore, and yet that's what many of us were raised to expect. Employers clearly aren't viewed any longer as being all powerful, and autocracies are not readily accepted. Some incorrect expectations may have been created either at the outset or along the way. Finally, as everyone knows, we're operating in a very litigious climate. There are many new laws protecting workers. Many are well-intentioned and doing much good. But I think we have too many laws and clearly we have too many lawyers. So the question is, can we as employers cope? I think we can, but I think it also takes work to cope. Communications are tremendously important. There's a necessity for company-wide communications so we can get a consistent message out to the employees. It is critical that written materials be kept up to date. Managers need training through seminars. They need to know the importance of keeping good evaluation records along the way, sharing those with employees, gaining agreement as to what was said and any kind of probationary discussion. Managers need sensitivity training so that they don't behave in ways that are no longer appropriate or accepted.

On the subjects of severance and release I suggest that we need to provide adequate or generous severance at time of separation. A quid pro quo for that may be a formal release document where appropriate. Finally, I mention employee liability insurance. Some risks are insurable and to some extent this seems to be one. There is insurance available in the market and we have purchased some recently.

My last topic is empowerment through profit centers. I'm speaking initially of Milliman & Robertson. We're a highly decentralized organization. We have 25 offices in the U.S. and 80 offices worldwide. We strongly emphasize professional freedom at the local office level. We believe our senior professionals are very capable, so we step aside to let them do their own thing after we've emphasized the companion responsibility and accountability that comes with that professional freedom. We have some 165 profit centers or subprofit centers within the organization of 900 people. We believe that local decision making authority leads to innovation and good client service. We don't have too many policies as an organization, but we follow those that we do have. We have an extensive quality control program. We emphasize risk management and bad risk avoidance.

The question is, are these ideas applicable to insurance companies? I think they are, and we have seen many examples in recent years. Strategic business units can closely resemble profit centers. Local empowerment through the delegation of responsibility to the operating units, agent reinsurance companies, and agent bonus plans are efforts of involvement, partnership and bottom-line profit sharing. There are other examples of value-added bonus schemes that also get into executive compensation. And finally, the greater the degree of local empowerment, the more important the bottom part of the planning process. Input from these so-called local presidents in the profit center or business unit then becomes critical.

MR. HASKINS: Our third presenter is Joe Brophy, a business consultant with Actuarial Sciences Associates. Joe is an internationally known expert in integrating technology into business strategy. Joe's early actuarial career, after graduation from Fordham, was with Bankers National Life, Prudential, and Hay Huggins. From 1971 to 1992, Joe was with the Travelers. During much of that time he served as chief

SENIOR EXECUTIVE OFFICER FORUM

information officer, with the distinction of having the data processing operation rated among the top three of the Fortune 500 Companies. Since 1988 and as president of Travelers, he focused on restructuring the Group Insurance Division into a highly profitable decentralized and empowered enterprise. In addition to his service as a director with the Life Insurance Marketing and Research Association (LIMRA), the Connecticut Opera, and the Hartford Chamber of Commerce, Joe is currently an external member of the Hillary Clinton Task Force on Health Care Reform.

MR. JOSEPH T. BROPHY: I don't want to lecture you on outsourcing but if you're not outsourcing, then you're probably losing ground. There have been books from Toffler and Drucker that have spoken on the subject. I just want to mention one perspective that is one of the driving forces: Small business owners, and managers of all ages, can adapt more quickly to new technology than their counterparts in larger organizations. So we're seeing a lot of entrepreneurial innovation out of all the advantages, including access to a diverse skill base. It's a phenomenon that is not going to go away. To access this, you may want to consider outsourcing if you have not already.

Improving the image of the industry is something I've honestly worried about for 25 or 30 years. I spent a lot of time with my previous employer focusing on customer service and quality. It felt like we weren't really making a whole lot of progress. I think we're too numbers-oriented and too paper-intensive in our business. However, I took a trip out to Motorola's Six Sigma Institute in Schaumburg, Illinois. Motorola is one of the leading proponents and practitioners of in-quality and customer service. It has paid off. They could produce products in this country or in Japan with lower cost and higher quality than the Japanese. As an example, at Six Sigma, six standard deviations is their goal. That's three errors per million. In preparing to go there, I sent all our data out and we had 99% success on achieving goals and objectives. At Six Sigma they said you're exceeding your 99% goal. Their evaluation was that we were almost as good as airline baggage handlers, and we were the best of the lot within the insurance industry. When I was leaving, one guy said to me, "Do you really know what 99% means? It means you drink bad water 15 minutes a day, you drop 15,000 babies in the delivery room, and you have three major crashes every week at major airports, so give that some thought."

Another factor affecting us as an industry is avoiding perverse strategies. We are shifting risk to the consumer through rescission underwriting and red lining. We can defend it from an underwriting point of view, but in today's age of communications and consumerism, if we want to follow these strategies as an industry, we need to educate the public and educate our legislators. With respect to the Asian broker consulting community, I look at them as our first line of defense if they're out there pursuing socially acceptable tactics. I am very critical of the Asian broker-consulting community. I can't tell you how many times as a manager of a very complex managed care organization I was required by brokers to deliver a plan that I could not service. I'm very pleased that one of the large major insurance companies in this country, after being awarded a bid, turned the bid down because they said they could not service the bid according to the plan design.

Positioning for health reform. I spent an awful lot of time in Washington. I was on a major task force established to bring electronics to the health industry, the work group

for Lake Bennett, and an electronic data interchange, working with the National Academy of Sciences. In fact, I recently spent three days with 41 physicians, most of whom had their Ph.Ds, one of whom was ex-Surgeon General Everett Koop. Two points here when you're thinking through your strategy. There's insurance reform and there's health care reform, and they're progressing at different speeds. Insurance reform, and a form of community rating which really tightens down on underwriting practices, will occur very quickly because nobody has the stomach for it. On the other hand, health care reform will take much longer, according to these physicians. Dr. Koop did not have much access to either Bush or Reagan, but he does have Clinton's ear. Dr. Koop says it's going to take a decade for health care reform to occur. The problem is people think it's going to occur quickly, but it's really going to be a long process. Some key points here. Health care is an information business. Surgery is a phenomenon of this century, and in the next century the phenomenon will be making health care an information business. Health delivery is a local business. Physicians are essential. I'm not sure about anybody else. In the final analysis, physicians will control health care delivery.

I grew up in Hell's Kitchen. I was a paramedic with St. Blade's Hospital before I became an actuary. I was thinking back and trying to decide what was the most advanced technology in the hospital when I was a paramedic. Guess what? It was the elevator. They've come a long way, but the technology changes that are occurring appear to be driving this country to single-payer systems, vertically integrated health delivery systems, and point-of-service health information systems. A lot of conceptual work at the National Academy of Sciences is focusing on how to capture all of the information you need at the point of delivery. Favored information for intensive organizations would focus on wellness and prevention and enhancing the effectiveness of primary dispositions. There is a very important role for actuaries. Our business and the health care business are information businesses. There is a great deal of opportunity for us to work with population demographics and psychographic information technology. Marketing research is something I've spent time on since my retirement. I've visited 40-50 companies over the last few months. Companies like National Decision Systems in San Diego have done a great deal of work in this area, and I think there is tremendous opportunity for actuaries to use their skills.

Chip technology started doubling about 30 years ago. If you double something for 10 years, 1,024; for 20 years, 1,000 squared; and in 30 years, you're up to a billion -- an important point. People get this point when you talk to them about it. It takes us 30 years to get to a billion components per chip. What happens in the 31st year if we go from 1 to 2 billion? It dawned on me that the last term of a geometric series is greater than the sum of all previous terms. Every year in this country, we are introducing new technology that's greater than the sum of all the technology that's been delivered since the inception of the personal computer. Information is doubling every 21 months. There are exponential forces at work. Gaps are widening between companies in our industry and between you and your competitors. You must put computer power into this sort of technical work and into your clients' architecture. When you go out and buy a PC, get your mainframe folks out of the loop of providing overall architecture. Use local area networks which are supportive tools. In 1980, I went out and bought 10,000 PCs for folks at Travelers. You must get that technology on employees' desks. It takes time (six to seven years) to get a

SENIOR EXECUTIVE OFFICER FORUM

computer-literate work force. You've got to measure the processes under a microscope to make a continuous quality improvement.

There are a few short-term actions to answer, what should I really do? If you're a manager and if you've got a problem, write it down, define it, empower a project team, get some business, get actuarial and technical people (with personal computer skills), set them loose, keep the mainframe folks out of the loop, and urge outsourcing for external databases, algorithms and information. There are tens of thousands of external databases that you can access. It's incredible. You can access anything you want or need to know. There are information companies popping up around this country, particularly entrepreneurs on the health side, but they exist in all facets of our business. You've got to put current models of computers on the desktops of your people; empower them; form project teams; keep the mainframe folks out of the loop, and set your people free.

MR. HASKINS: Our clean-up hitter is Dave Holland, president and CEO of Munich American Reassurance Company. Prior to joining Munich American in 1969, Dave held actuarial positions at Alexander & Alexander and at Bowles, Andrews & Towne. He completed his master's in actuarial science at Georgia State University. Dave has been very active in the affairs of the Society of Actuaries, having served on numerous Education and Examination Committees, with an emphasis on the Part 5 Examination, the Research Policy committee, and the Future Educational Methods Committee. He is a past board member and secretary and is a current member of the Academy of Actuaries Solvency Task Force as well as chairman of the ACLI CEO Task Force on Genetic Testing. Dave has served as vice chairperson and council member of the Reinsurance Section and continues to produce a steady stream of articles for the *Reinsurance Section News*. Dave was an author of the *1988 Report of the Society of Actuaries on AIDS* and has written extensively on the subject for the Financial Reporting Section, *Contingencies*, and the Actuarial Research Clearing House.

MR. DAVID M. HOLLAND: I'd like to start off by discussing some strategic issues.

IMAGE OF THE INDUSTRY

With respect to the image of the U.S. life insurance industry, studies by the American Council of Life Insurance (ACLI) show the public perceives life insurance primarily as a vehicle for protecting the family in the event of the death of the breadwinner. This goal is relatively less important now than it was in the past. Although there is still a need for protection from dying too young, individuals also are concerned about the risks of becoming disabled or from outliving their savings after retirement. These concerns have brought about a fundamental change in the life insurance industry.

After a rather steady growth in the early 1980s, traditional life insurance sales have become stagnant in the early 1990s (Chart 1).

New life insurance sales are over \$1 trillion per year, but 1991 sales were less than those for 1990. Although sales increased in 1992, they were still less than the level for 1990.

RECORD, VOLUME 19

Chart 2 shows the rate of change in face amount issued. The rate of change in face amount issued peaked in 1983 and has generally declined thereafter.

CHART 1
U.S. Life Insurance
Change in Face Amount Issued

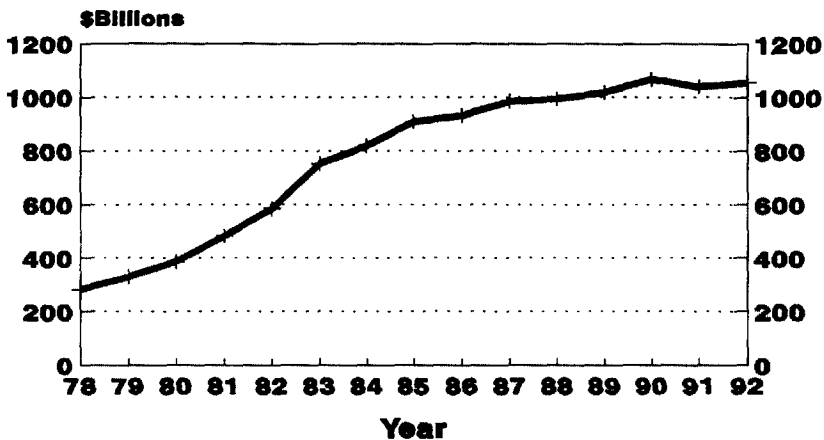
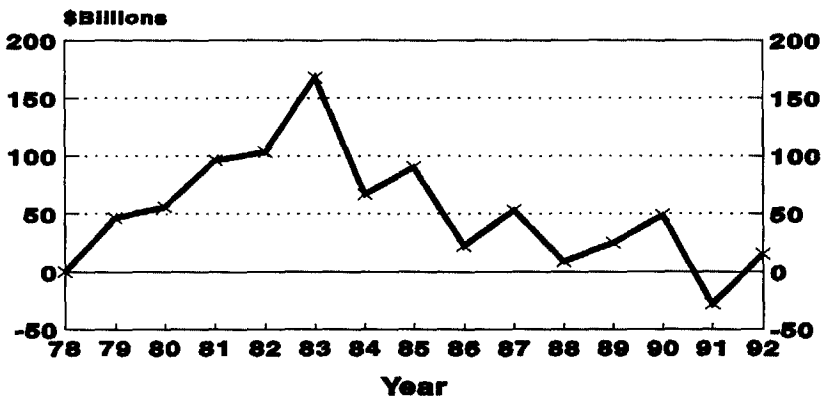


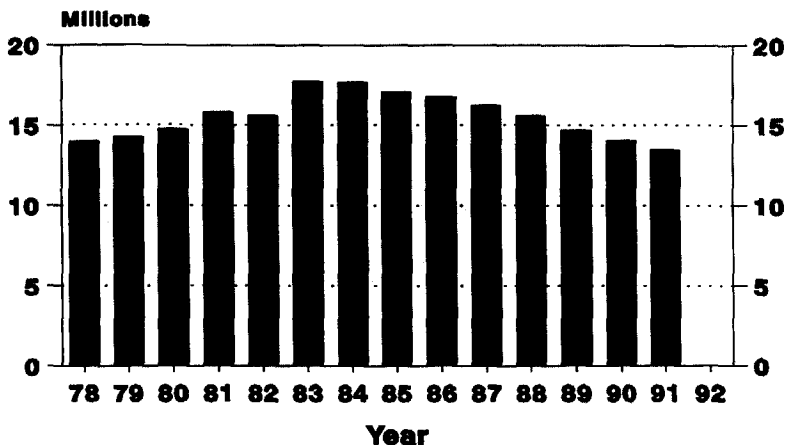
CHART 2
U.S. Life Insurance
Face Amount Issued



SENIOR EXECUTIVE OFFICER FORUM

Another factor is that the number of new policies issued peaked in 1984, and has declined every year thereafter (Chart 3). Indications are that this decline in the number of policies issued will continue through 1993.

CHART 3
Individual Ordinary Insurance
New Policies Issued



John Scully, President and CEO of LIMRA, reported in the May/June 1993 issue of LIMRA's *Marketfacts*, that "[In] 1992 the U.S. life insurance industry experienced the largest annual decline in recruiting in its history." The number of new recruits as reported by LIMRA is shown on Table 1.

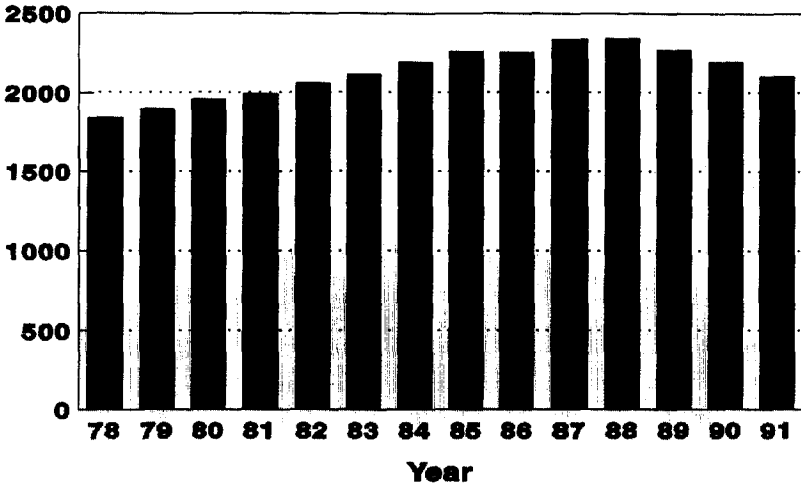
TABLE 1
Agent Recruiting LIMRA

Year	New Recruits
1991	34,672
1992	29,746

Although it is too soon to tell if this is a temporary phenomenon or a long-term trend, a decline in the number of new entrants to the traditional distribution system could have long-term consequences.

Chart 4 shows the number of U.S. life insurance companies as reported by the ACLI's *1992 Life Insurance Fact Book*.

CHART 4
U.S. Life Insurance Company's



The number of life insurance companies peaked in 1988 at 2,343 and has declined steadily thereafter. This is the number of legal reserve life insurance companies licensed in the U.S., but it does not necessarily identify the number of companies that are active or significant players in the market.

Table 2 gives life company statistics according to the ACLI (*1992 Life Insurance Fact Book*). There were 2,105 companies in 1991. According to A.M. Best (*1992 Best's Insurance Reports - Life-Health*), approximately 1,715 companies submitted data to them, and of these, letter ratings were assigned to 797. Another estimate of the number of companies in the market made by the ACLI is there were approximately 618 member companies for this period; however, this number would be further reduced if affiliated companies were combined into fleets. Another way of classifying companies is by surplus level. Best's reported that there were only 350 companies with surplus greater than \$50 million at the end of 1991 and only 120 with surplus greater than \$250 million.

TABLE 2
Life Companies

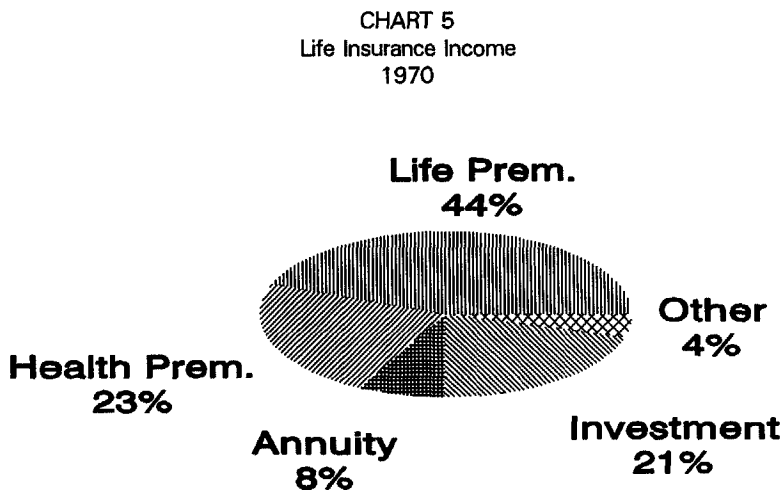
ACLI Fact Book	2,105
A.M. Best	1,715
Best - Letter Rated	797
ACLI Members	618
Surplus > \$50 million	350

From the data presented, it seems likely that we should anticipate a stagnant or declining role for traditional life insurance providing protection against premature death.

SENIOR EXECUTIVE OFFICER FORUM

However, there has been a transformation of the industry; the new role is seen in the growth of annuity business where the industry can provide financial security for retirement.

In 1970, the two major sources of income for life insurance companies were life insurance premiums and health insurance premiums (Chart 5).



By 1990, the two major sources of income for life insurance companies were annuity considerations and investment income (Chart 6). Life and health insurance premiums ranked third and fourth, respectively.

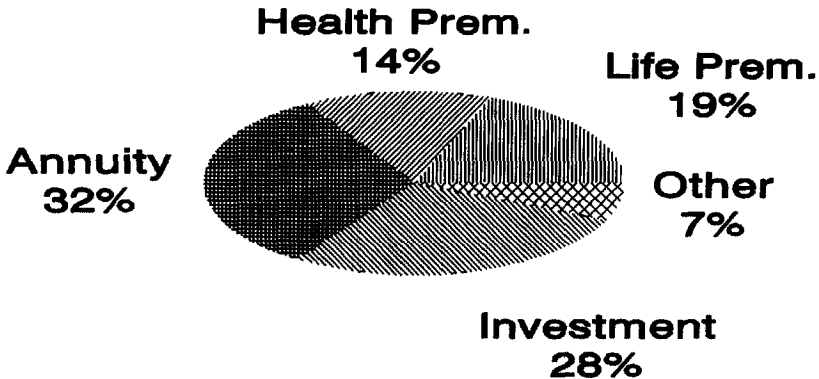
REENGINEERING

Given that a fundamental change has occurred in the life insurance industry, will there be a corresponding change in the organizational structure of life insurance companies? In terms of contemporary management wisdom, I would like to describe "reengineering" and tell how it has been applied to improve results in my company.

Reengineering is sometimes confused with downsizing. Although a significant reduction in staff may be one of the by-products, reengineering is quite different. The concept of reengineering was set out by Michael Hammer and James Champy in *Reengineering the Corporation*, subtitled "A Manifesto for Business Revolution." The book jacket modestly states, "Forget what you know about how business should work – most of it is wrong!" The authors state:

For two hundred years people have founded and built companies around Adam Smith's brilliant discovery that industrial work should be broken down into its simplest and most basic tasks. In the post industrial business age we are now entering, corporations will be founded and built around the idea of reunifying those tasks into coherent business processes.

CHART 6
Life Insurance Income
1990



On page 32 of the book, *Reengineering the Corporation*, Hammer and Champy formally define reengineering as: "The fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical contemporary measures of performance, such as cost, quality, service and speed."

Hammer and Champy cite three forces that are driving business away from traditional models:

- "Customers take charge . . . Customers now tell suppliers what they want, when they want it, how they want it, and what they will pay." (p. 18)
- "Competition intensifies . . . Good performers drive out the inferior, because the lowest price, the highest quality, the best service available from any one of them soon becomes the standard for all competitors." (p. 21)
- "Change becomes constant . . . The point is that not only have product and service life cycles diminished, but so has the time available to develop new products and introduce them. Today, companies must move fast, or they won't be moving at all." (p. 23)

My company has been involved in reengineering over the past several years. However, the term reengineering had not been popularized when we started our process. In the mid-1980s, our parent company established a Structure Committee with the charge to recommend a reorganization of the company assuming that we were starting from a "green meadow." We were asked not to focus on the world as it was, but rather as it should be. In *Reengineering the Corporation*, Hammer and Champy state on page 49:

Finally, we can do no better than to return to our original two-word definition for reengineering: starting over. Reengineering is about beginning again with a clean sheet of paper. It is about rejecting the

SENIOR EXECUTIVE OFFICER FORUM

conventional wisdom and received assumptions of the past. Reengineering is about inventing new approaches to process structure that bear little or no resemblance to those of previous eras.

Faced with the formidable task of reengineering, we considered numerous management theories and approaches. Of all of the texts surveyed, the principles set out in *In Search of Excellence* by Thomas J. Peters and Robert H. Waterman, Jr. were adopted as our basic precepts. In their landmark study, they identified the following eight attributes as characteristics of excellent, innovative companies:

1. A bias for action,
2. Close to the customer,
3. Autonomy and entrepreneurship,
4. Productivity through people,
5. Hands-on, value driven,
6. Stick to the knitting,
7. Simple form, lean staff, and
8. Simultaneous loose-tight properties.

We felt that there were basically three types of organizational models. Other models were basically hybrids or variations of these three:

- By function,
- By geographical region,
- By line of business.

The Structure Committee developed a detailed organizational plan for each of these approaches and then debated the merits of each. Our company had been organized along a traditional functional basis, and conventional wisdom told us that a functional organization would be the most efficient. However, we also set being close to the customer as one of our key criteria. Accordingly, when we examined our functional organization from the perspective of the client, we concluded that an organization consolidating functions into broader processes appeared to better achieve our objectives.

Consider the following somewhat exaggerated description of functional tasks. The client submits a request to a marketing representative, and the rep, eager to please, refers the request to a treaty specialist to draft the necessary treaty change. The treaty person's expert knowledge sets off a warning that this should be referred to administration to make sure we can properly handle the business. Of course, the administrative people can handle it, but they really doubt whether or not this type of benefit was considered when the actuary priced the product. The actuary, busy with other projects, refers it back to marketing to get more data. Once the data is received, the actuarial study is completed, the executive approves the change which is then referred back to marketing to send to the client. Although expert attention may be received at each step or task, the total process is interminable from the client's point of view.

We decided to consolidate the marketing, treaty, and actuarial functions into a Treaty Division which was organized on a regional basis. This has the benefit that marketing is now responsible for profitability as well as production. The actuary is responsible for responding to the client and not just completing a pricing project for the marketing

RECORD, VOLUME 19

department. Time lost due to handing projects off to different departments disappears because the activity is now centered in one department. Finally, the client benefits because the focus of the organization is on responding to the client's needs.

In addition to the functions handled by the Treaty division, there also are routine functions involving cession administration, premium accounting, underwriting and claims. These areas may not be the direct responsibility of the person who handles treaty negotiations, but they are just as important in meeting the needs of active clients. We decided to group these into a Client Services Division.

Again, from the point of view of internal simplicity, a functional organization seemed like it would be most efficient. The most basic administrative job was processing lapses. We could virtually hire someone off the street and with minimal training teach them to process lapses. However, when viewed in the light of being close to the customer, we concluded that we did not want to advertise that you should, "Do business with us, because we can lapse your business faster than any of our competitors."

Functionalization also led to different people responsible for yearly renewable term (YRT) business versus coinsurance. On the other hand, we did not want the client to have to talk to one person who handled their lapses, another who did YRT, and someone else who managed their coinsurance business. Again, we consolidated functions on a regional basis, so that people were responsible for certain clients regardless of the type of business. This required a greater level of expertise in our staff, but it also resulted in more job satisfaction for our people as well as improved customer service. This also led to improvements in productivity so that we were able to handle business with greater efficiency than under the functional organization.

The remaining functions involved accounting, corporate actuarial, data processing, personnel, etc. We felt these functions should be transparent to the client; requests from a client should not be delayed because people are working on the annual statement. We grouped these functions into a Corporate Services Division.

Not everything fit within a formal structure. For instance, it was felt that we also needed to take time to evaluate our accounts from a comprehensive point of view. In addition to the Treaty division, input was needed on underwriting, administration, and financial condition. To meet this need, we put together account evaluation teams from all divisions of the company. This also led to empowerment and increased job satisfaction; our people became responsible for what happens with accounts and did not wait to be told what to do.

Also, information technology plays a major role in our operations via a new general EDP concept. In developing the new EDP concept, there was again empowerment of our staff; project teams involved with joint application design were headed by users from the operating departments with people from EDP serving as facilitators.

Although our record is far from perfect, we are pleased with the success we have had. When I became president in 1987 and we implemented the new organization, my senior management asked me to enumerate the goals I had for the company. I set out the following five goals:

SENIOR EXECUTIVE OFFICER FORUM

1. Increase premiums,
2. Improve service to clients,
3. Reduce claims,
4. Reduce expenses, and
5. Develop alternate lines of business

Over the period 1986-92, our premiums are up 70% for our traditional lines of business. Claims as a percentage of premiums declined 30%. Expenses for this period grew at an overall annual rate of only 2%. Lines of business were expanded so that premium income for new lines exceeded the income for traditional business last year. Although not as directly measurable, we like to think that we have strengthened and improved service to our clients.

BUSINESS STRATEGIES

In March 1993, Ernst & Young published *The Role of the Insurance CEO in a Changing Environment* based on a survey of 172 CEOs of the largest U.S. insurance companies. In describing the industry outlook, they identified the following problems:

- Lagging financial performance,
- Asset problems,
- Competitive climate,
- Cost management,
- Distribution effectiveness, and
- Regulatory pressure.

Of the life and health companies surveyed, 48% were organized on a functional basis with 36% organized on a profit-center basis. Thus, reengineering may have potential for improving the organizational efficiency of a number of companies.

In identifying actions taken by the CEOs surveyed regarding restructuring, the Ernst & Young survey reported:

- 56% had discontinued a line of business,
- 33% had an early retirement program,
- 56% had other personnel cutbacks,
- 28% had sold one or more subsidiaries, and
- 41% indicated a major investment portfolio shift.

In 1993, the Life Office Management Association (LOMA) and Andersen Consulting published *Insurance Industry Futures: Directions for the 21st Century* based on surveys of U.S. and Canadian life insurance senior executives. The LOMA survey found that the industry is repositioning, and it is expected that there will be fewer, more specialized firms with lower expense ratios and better capitalization. Stiff competition (or opportunities for strategic alliances) is expected from nondomestic insurance firms, banks, stockbrokers and mutual funds, particularly those entities with more competitive cost structures. The LOMA survey reports the following strategies being pursued:

- Focus on return on capital,
- Customer based orientation,
- Non-value-added activities eliminated,

RECORD, VOLUME 19

- Reliance on information technology, and
- Restructuring of jobs

LOMA identified three tiers of competition: market leaders, fast followers and run-off companies.

IMPLICATIONS FOR ACTUARIES

Based on a June 1991 survey prepared by the SOA Task Force on the Actuary of the Future, SOA members felt that roles for actuaries have narrowed. Cited were competition from other professionals, employer perception of effectiveness, and failure to adapt to a new environment. The survey also indicated that demand has decreased as a result of economic conditions, corporate reorganizations, a decline in defined-benefit plans, and changes in the role of the actuary. At the same time, it is felt that responsibilities have increased as a result of regulatory volume and complexity, the role of the valuation actuary, greater demand for information, and asset/liability matching.

The number of actuaries continues to grow at a fairly substantial rate. There were 293 new FSAs in 1992. It may be interesting to note that the total number of new FSAs from 1949 to 1992 was 7,106 whereas the total number of FSAs as of November 1992 was 6,976. Although it may be of debatable value, I thought it would be worth comparing the number of Fellows of actuarial organizations to the number of life insurance companies over the past 100 years.

It is readily admitted that not all FSAs work directly for insurance companies; on the other hand, the number of FSAs is clearly growing much more rapidly than the number of life insurance companies (Chart 7).

As senior executives and actuaries, the challenges facing us are revitalizing the traditional insurance industry, reengineering our organization, and expanding applications to meet the needs of actuaries.

MR. HASKINS: If you look at our four panelists, the key words are reengineering, niche marketing, focusing, and technology.

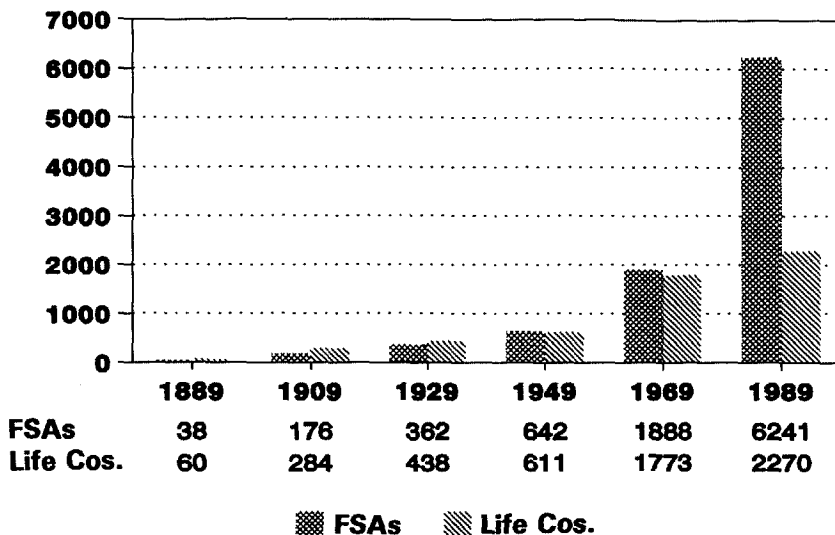
MR. ALAN N. FERGUSON: You used some words I didn't understand. You used psychographics. Is that a mad artist?

MR. BROPHY: Psychographics is measuring how people feel about things. In psychographics reality is not how we feel about things, but how our customers feel. It's a very interesting science that actuaries could master and make great contributions to, applying the technologies which I am now using on claim databases and so forth.

MR. FERGUSON: Why did you say that the technology is driving us to single payer systems? Would you explain that?

SENIOR EXECUTIVE OFFICER FORUM

CHART 7
FSAs Versus Insurance Companies



MR. BROPHY: I'm sorry, Alan, I didn't give you a lot of background. Most people are probably not aware that the brains behind the health infrastructure in this country rests with the Department of Defense, an agency called HARPER, which was formerly DAUPER. It is set up now by a physician named John Silva. They have an enormous amount of money and great talent that they want to take from the military establishment and move into health care. They're focusing on things like community CHAMPUS-type health care systems. I didn't give you all that background. When you begin to see where the brainpower and the muscle are and what they're doing with technology, it becomes pretty clear there's going to be a lot of pressure due to cost advantages, and the ability to capture information and so forth, to favor single-payer type systems.

MR. FERGUSON: You said that the physicians will be the key people, and I agree with you there. It seems to me that is due to the direction that some large companies seem to be going by setting up large HMO systems. It seems to me it's more likely to be smaller, community-based, physician-owned or physician-driven systems that insurance companies are well-positioned to partner or contract with and can service them with lots of the things that you mentioned, for example, risk-sharing mechanisms.

MR. BROPHY: Don't underestimate the physicians in this country. All we really need are physicians. We don't need insurance companies. We don't need managed care companies. The survivors are going to be the physicians with outstanding technology. That's all I'm trying to say. I don't think very many people understand where the power is. The power lies with the physicians.

MR. WILLIAM C. CUTLIP: We have heard several speeches with several challenges. One of the features in particular that captured my imagination was the discussion about switching from a thought mode of reengineering to imagineering: Thinking about the future and predicting what the future is going to hold and what we are going to do about and with the future. What techniques are you using now within your corporations to look at the future and to begin to think about what it is that you need to do?

MR. COLLETT: I thought I heard Dave say it was as much imagineering as reengineering and willingness to say how things should be. You must start with a clean sheet of paper. In our organization, I referred to the importance of the bottom up portion of the planning process that goes out to the practitioners who are on the front line. We assume that they're most apt to see it first and ask lots of questions at that level. We let ideas come up through our organization by branch, that is by health practice, life insurance, property, casualty and employee benefits. We do most of our planning as it relates to perceptions of the marketplace at that level. Then and only then our management stimulates and causes the planning at the top level. Then we synthesize at the end. But we really do most of our planning down at the consultant level and the discipline or specialty-group level.

MR. HOLLAND: If you wonder how the discussion of the image of the industry, which we usually think of in terms of various surveys of consumer attitudes, may become the reality that we have to deal with, the perceptions of customers and others become awfully important in understanding where we are. But I wanted to talk about the concept of the image of the industry from the point of view of a senior financial executive, someone who's willing to invest in a certain insurance enterprise. Would you put capital or resources in this type of concern from that point of view? I felt that we have to look at the structure of the industry. Our clients are life insurance companies and that's why I worry about how many insurance companies there are, what kind of products they are selling, and what kind of needs they will have. I don't know that we can come up with a good formula for imagineering. I wish I had one.

The clean sheet of paper is a good motto, but I think we have to look at the needs of the people. A good example is the concept of providing through annuities for retirement. We heard Senators Warren Rudman and Paul Tsongas tell us that there will be changes in the retirement system. I think there will be greater individual responsibility for dealing with products like that. The government would like to provide long-term care for us but no one has developed an affordable method. So there are a number of needs that we have to look at in terms of focusing on the services that we provide, the real purpose that we have for being in business. As we can look at those and focus, then we can ask questions that are more mundane like my simple five goals. How do you increase premiums? How do you reduce expenses? But I think we have to first lay a foundation for where we have come from to see where we're going, and try to figure out where we want to go as a fundamental process for this type of development.

MR. HARDING: As I heard the word *imagineering*, I focused on a time span ten years out and tried to identify forces that would change the moving target over that period of time. How would a company try to help shape some of those changes? In

SENIOR EXECUTIVE OFFICER FORUM

my own company, I don't think we're going to shape those changes in a major way ten years out. I think we have a better crack at it five years out, so our own focus has been five years not ten. In that regard, we're still learning in a customer-focused vein to understand better what our clients need and how we think those needs will change as technology changes.

MR. BROPHY: We have exponential forces at work, and you cannot measure what's going to happen in the next five years by using the last five years as a yardstick. We are in the midst of a major technological revolution in our country. It's going to impact all our lives, and I think you need to focus on what your core competencies are. You need to be lean, mean, thin, and agile because you're going to be asked to respond more quickly. In your product development you need to look at what added value you can provide with your products and with additional information services. We're becoming an information economy. Information is a product and you must weave that into your thinking.

MR. THOMAS F. EASON: A couple of comments about imagineering. I hope many people will come down to Orlando in 1994 for the two society meetings. Somebody there is imagineering. There are 16 new hotels going up and \$4 billion worth of construction was announced in the last 30 days, so perhaps you'd be inspired. There's a book out that gives some other ideas. It certainly gave some to me. I was happy to see Dave Holland give a pitch for *Reengineering the Corporation*. Our chairman recently passed out 200 copies of that book within our company. I found a book called *The Virtual Corporation*. If anybody on the panel has seen that, you might comment on it. It was filled with technological revelations, some of which we can implement very soon. I have a question for Mr. Brophy. Two weeks ago we signed up to outsource all of our mainframe computer systems with new fiber optic technology to different cities. We'll have that done within a year. You were very strong on outsourcing. Could you elaborate on the importance of that to this industry.

MR. BROPHY: *The Virtual Corporation* goes hand in hand with the whole concept of outsourcing and having in-house control of your core competencies. Highly skilled knowledgeable workers can pick and choose the various technologies out there. For example, 91% of the people that bought a Lexus bought it off a mailing list developed by National Decision Systems. They developed that mailing list before Toyota even decided where to put their dealership. There are incredible skill bases out there that I think we're too insular as an industry to use. But I think virtual corporations of the future will be the corporations that can break into small, highly focused units and transfer most of their core structures in variable cost and access to diverse skill bases that are out there waiting for us. It's a movement away from the turf orientation that I'm so familiar with, having spent 30-40 years in a couple of great companies, which were also big overgrown bureaucracies.

MS. ANGELICA B. MICHAIL: This is a question for Mr. Collett. Empowerment, it's a wonderful word, but I was wondering exactly how you implement it in your company? What strategy are you using to minimize risk of errors? And what do you do if somebody makes an incorrect judgment that costs your company money?

RECORD, VOLUME 19

MR. COLLETT: I think the empowerment comes through minimizing the numbers of rules, and not directing things to a central location for execution, but having the local consultant teams capable of delivering complete answers. Beyond that, I mentioned some of the quality control measures with which we balance that, for example, the notions of peer review from one office to another, the strong orientation towards the clustering of the professionals within a single discipline, such as the Life Insurance Steering Committee, and the director of that portion of our practice. There's a very strong affinity among those within a particular discipline. As far as the possibilities of errors, I guess we feel that errors are made by human beings but that errors are caught by other human beings, so we have very extensive prerelease review rules and expectations of our consultants. We don't have a lot of policies, except in the areas of signature authority and peer review. To minimize errors that are made and not caught, we have malpractice avoidance training for all of our consultants starting at a fairly low level. New ASAs get malpractice avoidance training and other training through orientation programs. We also have expectations of them at each level. We have professional malpractice insurance at the end of the tunnel as the protection of last resort. And we have a number of policies in terms of assignment considerations on the front end. There are certain assignments you simply stay away from because there's a built-in problem either with the organization or the type of work that's involved.