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Effective Use of Services Available to Small-Company Actuaries

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Summary: This panel discusses how best to outsource to informed consultants and to other company personnel. Senior industry practitioners provide valuable insight into the most effective use of actuaries and management consultants, Actuaries Online, reinsurers, technologies, and the legal profession.

Mr. Craig K. Nordyke: I am vice president and chief actuary of Paragon Life Insurance Company in St. Louis, Missouri. We are owned by General American Life, but we only have 60 employees. I think I qualify as a small-company actuary. We do some services, obviously, with our parent company. Many times we also look to outside services. I think we have a great panel here that can describe some of those services available to small-insurance-company actuaries.

First will be Jeff Stevenson. He's president of Stevenson Associates. Next is Bob Grieb, who is the founder of Diversified Services Group, a research marketing group. Doug Knowling is a consultant with Tillinghast-Towers Perrin in St. Louis.

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We also have Frank Barrett, who is Counsel of Kennedy, Holland, DeLacy, and Svoboda, a law firm in Omaha, Nebraska.

Jeff Stevenson is president of Stevenson Associates. It's a company providing consulting intermediary services in reinsurance, with a particular focus in financially oriented reinsurance transactions. He has over 20 years experience in the industry. Prior to starting his own company in 1995, he was with ITT Lyndon in St. Louis, as the vice president and deputy chief actuary. Prior to joining ITT, he was with Mass Mutual Life Insurance Company and also Security Mutual Life Insurance Company of New York. Jeff has experience in reinsurance pricing and risk analysis of financial reinsurance transactions. He's going to talk about financial reinsurance intermediaries.

Mr. Jeffrey G. Stevenson: I am working as a consultant and intermediary in reinsurance. I'm going to discuss how a small-company actuary can make use of services in the reinsurance or outside services to get expertise. The challenge of the actuary in a small company is that the actuary wears many hats. Interesting, I was invited to speak by an associate from my former company. On his bookshelf in his office he has a series of baseball caps with claims, marketing, actuaries, systems, and what not labels to signify that he does indeed wear many hats. Try going on your own to be an individual consultant and then you really get a few more hats.

The reinsurance area has just become more and more complicated with regulations. For example, there are different accounting rules if you reinsure new business or in force with different accounting rules in GAAP, and there are tax implications. What do you do? You go to your reinsurance actuary you have in house, right? We'll talk about how we can access some services outside, particularly in the area of reinsurance. Of course, the gambit is consultants, reinsurers, and intermediaries. They're all out there and can probably help you in some respect or another. I'm going to talk about each one of those and how they can help you out, perhaps in your role in handling reinsurance. We will discuss a few examples, their real life situations, and perhaps we can have a little bit of dialogue on what might be appropriate in certain circumstances. Remember I talked about consultants, reinsurers, and intermediaries. Those are our resources on the reinsurance side.

Certainly consultants provide expertise and they're really good for specialized projects, particularly if they're one-time projects and they have nonrecurring expenses. OK, well what's the downside with consultants? There's going to be a direct budget impact to your cost center.

Let's talk about reinsurers. I used to work for a reinsurer and small company as well; therefore, I have some perspective. One thing reinsurers are doing more and more is providing product development help. A number are providing product development support and that's a very good source of expertise with reinsurers. Certainly, the traditional things like underwriting assistance, particularly on the facultative side, and mortality assumptions are also available if you have a new line of business, for example, and want some guaranteed issue product perhaps. What are you going to do for assumptions? The reinsurer can really help out in that area as well.

Another thing that we see is reinsurers that provide system support. A number of reinsurers see these services as a value-added service. A translation for value-added means that it doesn't necessarily have a direct budget cost. However, like with anything else, I guess, there's no free lunch. There may be an impact of these services in your reinsurance costs through the reinsurance cost itself or tied in through systems or product development. Certainly, these are valuable services available.

The last category is intermediaries. Intermediaries, certainly on the financial reinsurance side, can provide specialized expertise in structural issues such as nontraditional reinsurance and the regulatory implications I mentioned earlier. Why not intermediaries versus a reinsurer or consultant? The intermediary has been dealing with lots of reinsurers in different companies and therefore has a lot of experience in that regard. You know, the consultant might not be as experienced. Certainly reinsurers can be helpful. They're also representing their interest. If you want to go out and seek reinsurance directly, you start calling up reinsurers, then what happens? Soon you're on the phone quite a bit with the reinsurer and spending a great deal of time explaining your products, your distribution, and supplying them with information. I think an intermediary can help you save time in that respect by being your focal point with the reinsurer. Another positive to the small-company actuary, when we talk about the good old budget, is cost. Some transactions can be structured so that the reinsurer pays the intermediary. That's usually out of the share of the reinsurance arrangement.

Let's look at a few examples of each of these resources: consultants, reinsurers, and intermediaries.

Suppose you wanted to increase your retention limit. This is a scientific process with much expertise required. What do you think would be a good source for guidance on increasing your retention limit? I think that would be a good one for a consultant. It generally requires a lot of specialized expertise. Of course, your reinsurer can help you. But let's go one step further. You want to not only increase your retention limit, but you might want to recapture some in-force reinsurance. The reinsurer might not want to have your retention so high. Go one step forward.

Suppose after you increase your retention limit and recapture your in force, maybe you then want to go out and seek some kind of replacement reinsurance. Actually, in this particular example, depending on what you're doing, you probably would use a consultant, intermediary, or a reinsurer. I want to just try to give you a flavor for the considerations there and what might be appropriate in various reinsurance efforts.

How about another example, a new product development effort. Remember, many reinsurers now are helping out with new products. It's great service and it can really add some value, particularly if it's a new product that involves some specialized underwriting. You may need to set some mortality assumptions, or let's not forget our illustration regulation that is coming. That regulation requires you to base your assumptions on actual experience. I would think a reinsurer might be of help in that area. Certainly a consultant would be very good in product development support in any of these things.

How about an intermediary for assumptions such as these? I'm not sure an intermediary could provide the same support for product development and assumptions. So in this example, maybe an intermediary would supplement this if reinsurance was involved.

The last example is a specialized financially oriented reinsurance transaction. A vehicle to support new business, support your capital strain, and maybe even cash to support cash commissions, is the specialized reinsurance arrangement. Interestingly enough, depending on how you structure the transaction, financially one reinsurer might have a particular advantage over another. So just calling your regular reinsurer might not get you the most attractive reinsurance arrangement because some reinsurers are positioned differently financially. This is probably a good example for favoring the intermediary over the consultant or the reinsurer.

In summary, remember we have reinsurers, consultants, and intermediaries. As I mentioned, it seems like reinsurers and intermediaries are more value-added service providers. You don't see the direct budget cost. I think that time savings can be significant utilizing an intermediary when shopping for alternatives. When it comes to when you really need real expertise, I think consultants, intermediaries, and reinsurers can all be of value. I think in the area of reinsurance, there are many outside services that you can access to successfully manage your priorities.

Mr. Nordyke: The next presenter is Bob Grieb. Bob is the founder of Diversified Services Group (DSG). He brings clients over 20 years of diversified financial services management experience. He's held executive positions in large and small insurance companies, agencies, and securities firms. He's also had a position in a super-regional bank, multi-state thrift, and a registered investment company. In 1989, he started his own consulting business in a variety of financial services companies including banks, insurance companies, thrifts, and so forth. He has held previous positions and executive positions at Colonial Penn Group as well as Philadelphia National Bank. He holds a bachelor of science degree from Lafayette College and a master's in business administration from the Wharton School.

Mr. Robert F. Grieb: I'll give you a little bit of an overview of DSG, so you get a sense of where we come from. Let's discuss strategic planning and strategic management because I think that really drives research. Then we'll talk about some definitions of research, and if we have time, we'll talk about some case studies.

Just in terms of DSG, our focus is very much in financial services and securities, banking, and insurance. We operate in three different areas: consulting, research, and publications. We publish the *Bank's Securities Journal*, which also now overlaps and does quite a bit of coverage relative to insurance coming into the banking area. We are also developing information and databases so that, hopefully, we have something that has some equity.

In the consulting and research area, I would call us a strategic consulting and research firm. Our orientation is probably much more towards the distribution side of the business. We don't have a single actuary on staff. I felt sort of strange up here sandwiched between an actuary and a lawyer. One of the things that we do is run a program called Insurance Warfare. This is a development program for insurance executives which gives us a lot of exposure, not just to the people at the enterprise executive strategic level, but also operating managers. It is a simulation-based training program that has been effective over the years.

Just to put the way we view research in context, we come at it from a strategic management perspective. Strategic planning used to be something that you did every five years whether you needed it or not. It created these big thick books, and it was a real bother. It's changed significantly, it's now a continuing process in most companies. We use just a continuum of situation analysis which we think is key. Planning, implementation, monitoring, reading your results, analyzing them and going back and relooking at your situation. Strategic planning really helps you answer the key questions: Where are you? Where do you want to go? How do you get there? Why do you do it? To set goals and direction, communication is important, having everybody in the company really understand where you're headed, being able to monitor progress. The last point here is, the world is changing. It's changing rapidly. If you don't keep up with it, you're going to be left behind. One of the things we do in the training program is have people line up in the room based on when you came into the industry. We'll collect some ideas of what was important from the late 1960s through the present. We look at maybe five-year blocks, customers, products, legal or regulatory issues, technology, and these types of thing. It's incredible how much things have changed. If you don't keep up the great strategy you had in 1980, it won't do you any good in 1997.

At the core of that is, we feel, a situation analysis. Looking at the external environment, your internal environment, and particularly at competitors leads to what we call "SWOTS." You have probably all heard of these: strengths, weaknesses, opportunities, and threats. I think this can help point you in the direction of where you need to focus your strategies and looking at strengths and weaknesses and trying to line them up with opportunities and threats. If you have opportunities that line up with strengths, you ought to be looking real hard at all kinds of strategies. If you have threats that are lining up with your internal weaknesses, you sure better be looking at defensive strategies or you're not going to be around. Others become more situational.

All of that said, we come to research. That can really help in doing the situation analysis, and what we're trying to do is help people to look at markets, products, and distribution. What you want to do is get those three circles on line so that they're concentric. You might look at employees, looking at attitudes or what their beliefs are. One of the things we'll often do in a consulting assignment is what we call a belief audit. We'll go in and talk to or develop a questionnaire from employees, and it's amazing how much difference you find when you ask, what's the direction of our company? What are our strengths? What are our problems? You get a wide range and what you find is that often it is a communication problem and there isn't a consistency of beliefs within a unit.

Looking at existing customers, past customers, customers of competitors, as well as your own, understanding what consumers are actually looking for are all important. You should consider distributors, your agents, or whomever you're using; research your competitors and it might be competitor products or the companies themselves. Then actually look at the environment. What are the trends from an economic perspective or from a regulatory perspective that are going to really have an impact on your business over time?

I'd like to clarify the difference between quantitative and qualitative research. With quantitative research, you're maybe surveying hundreds or thousands of statistically significant samples, getting more discrete pieces of data or information. Qualitative research involves, for example, focus groups where you get small groups of people together. You're discussing issues, you're discussing how people feel about things, and how they react to different positioning.

Let's discuss primary versus secondary research. Research doesn't have to mean you hire a firm and conduct your own study. There's a great amount of research that's out there in the public domain. With secondary research, the first thing you ought to do when you want information is go look at what's available in the public domain because there's a tremendous amount of information out there. Knowing how to look for it and where to look for it is a key. The good news is the access of information with the proliferation of the Internet; the bad news is the access of information because there's just so much of it. It's becoming much more a science to learn how to find relevant secondary information.

Distinguish between proprietary research, syndicated research, and club studies. With proprietary research, you design your own project and you do it for your firm. It's your project.

Syndicated research is where a firm like ours may design a study and go out and solicit and try and sell it in advance to maybe half a dozen buyers. Different firms all participating in the same study. In those types of projects, it's more efficient than primary research if there's a group of companies that are after the same question or topic. We may customize pieces of it, so that Company A is getting a little bit different read than Company B and Company C. By coordinating the effort, it's much more cost efficient.

Club studies are a little bit different. They will tend to take place where you have different companies that get together to research each other. So you may have six different peer insurance companies who want to find out, obviously without going against the anti-trust laws, what's going on within the different companies or within this group, so that they can benchmark themselves against their peers over time. This can be done in a way so that you're not exposing individual companies, but you may have, say, six or ten or twelve different companies. You collect information, you aggregate it for all of the companies, but then you can look at your own company's information against the peer group.

Focus groups are groups of people together with a moderator, discussing a particular topic area. They're great to understand positioning, understand how people feel about different concepts, and how they react to different presentations.

In-person interviews, often at an executive level, are helpful. Telephone interviews, surveys by mail or phone, or, increasingly, electronic surveys can be utilized. Consumer panels are a project for larger research firms, not a small firm like ours. We will have consumer panels where they're going out on a monthly or a quarterly basis to different preselected panels of people, and I know they're going to call me every other month and they'll ask me a series of ten questions. They've got me categorized by demographics. This is an inexpensive way to go out if you have consumer questions you can plug into one of those panels. In a very short period of time and very efficiently, two or three questions are answered by a large sample, targeting on specific demographics at different points.

Attitudes, awareness, needs, wants, opinions, knowledge, result, strategy are all the different kinds of things you might be looking at. Market sizing is another form of research. As an example, let's say you're interested in the bank market for the distribution of annuities or the distribution of mortgage insurance.

Competitor benchmarking can be a couple of different types. You can benchmark products or you can benchmark actual competitor companies and what they're doing. Some of the ways that I think that research really relates directly to actuarial work is helping you with product design. You come up with a product concept and test it to see if the dogs will eat it. Does it make sense?

Looking at applications, we've done work where you create an application form and test it to see whether people use it. Will they give you the right information? Have you communicated properly what you want? Is it coming back properly? Presentation of information, whether it's for agents or for individual consumers, must be clear. How do you present your story, your products? Testing pricing is a little bit more sensitive from a research perspective because your answers sometimes are different when you ask, "Would you buy it at this price?" versus "Here it is, buy it."

What are some of the keys for successful research. First, define the business objectives. In large companies, you get a research division and sometimes research becomes a means to an end. There should be very clear specific business objectives or business problems that you're trying to solve with research. The project design is critical. The methodology you use, the type of research, the medium, sampling, its source, composition, and size are all important. You should design a questionnaire or a topic guide for a research project in a way so that you don't get bias feedback. Capturing, tabulating, and analyzing data properly are factors. A participant inducement is one of the things to consider if you're going to research an executive. There's going to have to be an inducement for you or somebody else who's a target of that research to sit down and talk to the researcher for a period of time. Very often we'll use things like a summary report. We'll give that to participants so they get value out of their participation. However, what we give to participants is clearly not the level of analysis that we're giving to the client.

On the individual side, it may be a dollar to fill out a questionnaire or it could be as much as $50 or $100 to come to a focus group for two or three hours, depending upon the type of person you're trying to target. Setting your research budget is important. Manage expectations, be realistic in terms of what you're expecting. Research is just that. You're looking for information. Why use an outside firm? To keep yourselves, as a sponsor, anonymous as well as to keep the respondents anonymous. You can't go ask questions of your competitors. Maybe I can in the right context.

If you're dealing with customers or agents to prevent unrealistic expectations, we've done, for instance, research going to agents trying to understand what their needs and wants are, what they're looking for from a customer. If the company is asking those questions, all of a sudden it raises expectations. If I'm a researcher, I'm doing it anonymously. This doesn't create unrealistic expectations on the part of the company. It will also prevent bias. If you tell your regional vice presidents to go out and survey their agents, you're going to get back a whole different set of answers than if somebody else does it. You can have bias on the part of the researcher. You have bias on the part of the respondent. If I know your company is conducting the research, maybe I slant my answer either positively or negatively. Benefit from other experience, expertise, and get access to people. Again there are limits as to what you can do as a company in terms of accessing from consumers to competitors. Select the right firm. Look for relevant research experience for the type of project you're doing. Generally industry knowledge is a plus, particularly because it helps people to understand your specific issues.

What I'll do now is highlight some of the types of research we did. Distributor research—we had a situation in one case where this happened to be a property and casualty company that had agents ranging considerably in terms of how successful and how profitable they were. The company wanted to determine what it was that made them profitable. We worked with them to analyze and segment the agencies based first on performance. Then we developed a very detailed questionnaire which really examined a whole range of independent agents' activities.

We first conducted telephone interviews, so we could test the way we ask the questions. We could see how people responded to them. Where we hit sensitive issues, we got some answers back that told us there's some other questions we should be asking. Then we could hone in and get together a mail survey, and then we mailed out a very large survey. Basically, we found the factors that actually correlated with superior performance, and it allowed the company to understand better how to target the agencies and how to move others up into that top tier.

In this case, we used quantitative and then followed it up with qualitative research from an attitudinal perspective. That really helped them to develop specific strategies.

The next item is service standards. This was a situation where a company felt like it needed to provide better service, but it wasn't sure how. It had certain standards within the company. We ended up doing this on a fairly large sample telephone survey. We actually got quantifiable data, but also qualitative data, in terms of the feedback we got. We found that the way the company describes service and the way the agents describe service was very different in some cases. Definitions of standards were different. For example, the underwriting department says, "The decision is out in five days;" but the agent says, "I want it done in five days." Each is talking about two different things. The agent expects from the time it is sent until the time it is back, while the company underwriter is viewing it from the time it hits the desk to the time it leaves the desk. We also found areas where the company wasn't paying any attention. Serious gaps between what was important to the agents and their satisfaction level were discussed. So with this type of research, the company actually changed its service standards and also modified its compensation for its home office people.

Another example was a company that has been operating in a captive environment. It lost basically the core of its business. It had to go out and look at the rest of the world and identify what the market was, where the key competitors were, and where were the niches that were available.

Mr. Nordyke: Doug Knowling is a consultant with Tillinghast-Towers Perrin in the St. Louis office. He provides consulting assistance to the insurance industry, primarily in the areas of product development, financial analysis, asset/liability, and cash flow analysis. Most recently he has been involved in the NAIC life insurance illustrations model regulation. He's a member of the Society of Actuaries Task Force on Sales Illustration Practice Notes, which is focusing on the efforts to comply with this regulation. Doug joined Tillinghast-Towers Perrin in 1992, and prior to that time he was with Modern Woodmen of America for six years.

Mr. Douglas J. Knowling: For those of you who are the only actuary or in companies with five or less actuaries, you know that the small-company actuary wears many hats. There's product development, you have to price your products. You have financial reporting responsibilities. You are a liaison with regulatory and rating agencies. You might work with distribution analysis, as well as just general quantitative analysis that you might be asked to perform for your company. So besides waving a white flag, you might seek a consultant. You also might want to ask, "How can I keep control of the relationship?" Of course, consultants are going to line up outside your door. They're offering a vast list of products and services. A typical consultant might offer specialized unique abilities or the most advanced software available. I believe that consultants, if used properly, can be a valuable resource. I'm going to talk about situations where I think, under traditional actuarial-type, problem-solving, consultants should be used; a few times when I believe they should not be used; and some thoughts on controlling the relationship with the consultant.

I think there are three general situations when it makes sense to bring consultants in on a job. The first one would be the general situation where you have a resource shortage. This is an area where you probably have in-house capabilities. Perhaps you know how to price a participating whole life product but, because of various reasons such as a short timeframe, you want to get it to market as soon as possible. If you have project overload and you're not able to get to the assignment as quickly as you'd like, this is a good time to bring the consultant in and get the work done in a timely manner.

The second situation is when special expertise is needed; for example, a new actuarial practice, something that you haven't been exposed to in the past. I know when the valuation actuary work first started coming out, we got a fair amount of work, primarily a high-level review. This is also true in situations where the practice may have been around for a while, but not in your company. An example would be where a company was entering late into the universal life arena. While there was plenty of expertise around the industry, maybe within your company, universal life product development wasn't something that you dealt with. I think right now asset/liability management is something where some of the larger companies have been doing it for a while but some of the smaller companies are just now getting into that. That's an area where you might want to bring the consultant in to provide this expertise.

We try to do many assignments where, when we're done with the project, not only do we hand it off to the client, but train the client on how to do it. Not only do you get the consultants to get the assignment done, but you also get a chance to learn the specialized area of expertise and bring that in-house, so that you can perform it going forward. It's another way to add value; not just getting the job done, but giving you something you can use going forward.

Sometimes you might want to bring in a consultant just because the consultant is the outside expert. There might be circumstances where it's a sensitive issue internally. You might want to have somebody else who's going to get the daggers thrown at them rather than yourself. Sometimes just having somebody come in from the outside with a different perspective can be viable.

I think the third situation is when you need an independent opinion. You might want to have a third person do regulatory opinions such as cash-flow analysis for valuation actuary work. We've also had some assignments where a client company was getting ready to talk with one of the rating agencies. It wanted to get a special point across to the rating agency on something unique about its company, but the company felt that if it just explained it with its own information, the rating agency might view it as being biased. By having a consultant come in and give an opinion on a particular issue, the feeling was that it added more credibility to the items being analyzed and presented to the rating agency. Another area where independent opinions might be needed is the area of actuarial appraisals for a merger or acquisition activity. For small companies, I'm not sure exactly how well that fits in. Certainly if you were on the seller side of the equation, you'd want to have a fair-value opinion of the value of your company.

When shouldn't you use consultants? Well, I think the first situation would be low priority work. I'm sure you're all aware that consultants can be quite expensive. So you want to get the most out of your consulting dollars. If you're spending money on consultants for projects that don't even have a high priority within your organization, that's probably not your most effective use of resources. I think repetitive work is an example where you should not use consultants. If it's something you do on a regular basis, more than likely, you can hire that work in-house at less cost.

Implementation of a new product or some new procedure or analysis in your company might not be a good time to use consultants. You need to give intimate knowledge of all the ins and outs of the assignment. If you have that done by an outside party, that may cause problems down the road as far as not understanding what's actually happening at your company.

How do you keep control of the relationship? First, you need to evaluate what your needs are. As a consultant, I'd like to do as much for my client as it possibly would ask me to do. This is standard instinctive behavior. However, you don't want to be talked into something you don't really think you need. If you evaluate your needs, determine what's most important to you and share that with your consultant. You want to evaluate the skills of the consultant. Not all consultants can be all things to all people. You might want to bring in the best one for any one particular job. You want to make sure you define the scope of the project. In other words, say what is to be done and what is not to be done, so that no one exceeds their bounds and everybody is satisfied with what's being done. I think the consultant can help you define the scope. This is particularly true in a new area where you may not know exactly what does need to be done in detail.

Finally, you need to communicate your priorities during the project. I am aware of certain situations where perhaps the consultant did a very good job with the particular assignment; but because it wasn't exactly what the client company was looking for, there was a problem because the communication broke down and the priorities were not in line. Actuaries who work for larger companies generally have access to other actuaries. For the small-company actuary, this generally isn't so. I would suggest that a consultant with whom you have a solid relationship could act as your colleague. A consultant with a long-term focus is going to be willing to take the time to build that relationship with you and try to be part of your team.

Mr. Nordyke: Our last presenter is Frank Barrett. Frank is an attorney. He's currently in the position of counsel at Kennedy, Holland, DeLacy, and Svoboda in Omaha, Nebraska. He's also a consultant for the Mutual of Omaha Insurance Companies. Prior to his current position, he retired in 1989 as president and chief executive officer (CEO) of the Central National Insurance Company of Omaha. He had held many positions with that company. He was also executive vice president and chief counsel for the Mutual of Omaha Insurance Company and Affiliates. His bio is two pages long, so I tried to pull out some of the highlights for you. Frank has vast experience in the insurance industry. He has written a number of papers and is going to talk to us about the use of attorneys for small insurance companies.

Mr. Frank J. Barrett: Kennedy, Holland is a firm that deals primarily in insurance litigation, defense litigation, and regulatory and compliance matters. I've been asked to provide you with just a few ideas, a few thoughts and suggestions on outsourcing legal services for the small- to medium-size life insurance company.

Today in the brutally competitive world that you live in, the unsettled marketplace, the adversarial regulatory system, unfortunately we seem to be getting into a judicial system which has run amuck. The survival of the small, the medium-size life insurance company is in danger, which is strong language. But it's true. For example, if your company has an accident and health portfolio, if you write any interest-sensitive programs, if you sell through a captive or a noncaptive market, if you employ people, if you write life insurance contracts, you will have problems or you already have problems.

Add to these external competitive problems your company's own internal situation, as far as cost containment is concerned, and I believe you have an organization that is faced with doing more with less in a very difficult business climate. Basically, what I'm here to talk about is the hiring of independent contractors for certain particular functions or problems within your company.

I asked actuaries, "How many of you have law departments within your company, and how many have two or more lawyers?" I found that there are a number that do have law departments, and I'm going to suggest that many life insurance companies that I know and that I work with have well-qualified knowledgeable in-house counsel or a law department. Often, however, they need help. Generally, the in-house counsel is not a specialist. He or she is a generalist and that's out of necessity.

This is particularly true for the small to medium-size companies, because they can't possibly afford to have a lawyer on staff that has specialized knowledge in all of the areas in which you face problems or business.

I call my plan for small- to medium-size companies the DEMAND plan. I'll spell out the items that I believe are paramount in selecting your counsel: D-decide, E-evaluate, M-manage, A-articulate, N-nurture, and D-document.

The first issue is "D," decide the company needs. This is not always easy. It is absolutely essential that key management personnel within your company be involved in determining the specific needs, as far as outside lawyers are concerned, as to the legal matters facing your organization or that will face your organization. If you've not already been hit, you will be hit, you can rest assured of that. The question is, what kind of assistance do you need? Do you need general help? Do you need specific help such as litigation? Litigation is somewhat different than the general activities because when you have a lawsuit, you must respond to it quickly.

Do you need help with respect to litigation? Is it corporate affairs, regulatory compliance matters, or other governmental affairs? Just where does my company need the help? That question has got to be answered if you're going to get the benefits of outsourcing to lawyers or a law firm. I mentioned lawyers and a law firm. My personal suggestion to you and my recommendation is that you don't hire a law firm. I suggest that you hire a lawyer. By hiring that lawyer you ought to then find out what kind of backup he or she has. I'm suggesting to you that the closer you can tie your relationship, your company to that law firm or that lawyer, the better off you are, the better services you'll get and the lower cost you'll incur.

If your company has a formalized plan of action, because it has already gone through the process of its mission, its objectives, prioritizing its strengths and looking at its weaknesses, it is extremely helpful. It is the weaknesses that we get to as far as lawyers are concerned, because that's where you see the problems. If it's a strength, generally you don't have a lawsuit. So I would suggest you organize your decision team carefully. I would suggest that you bring key people in from all the departments to evaluate what you need. It's extremely helpful to your in-house counsel if he or she can get the input from the other members of the management team, and I would suggest that the president, chairperson, or CEO be involved in that process.

Then the next thing I'd do is have a series of meetings. I would have an outside person act as a facilitator. I would also work from the agenda in selecting the areas that we think we need help for within the company as far as outsourcing legal work is concerned. It's extremely important that this be a definite program.

Now you've decided you need a lawyer. Then we go to step E, and that's the evaluation process. The question becomes who do you select and why. I believe that the grapevine is an extremely important tool for management to use to determine just exactly who it ought to look at with regard to outside counsel. Companies that are similarly situated to yours can be very helpful in giving you knowledgeable information about who they use and why.

There are a number of articles written about how to "E,"evaluate law firms or lawyers and the selection process for outside counsel. I would suggest that you create your own questionnaire and your own approach to selection. It's how to look at what others have done and what others are suggesting. It really is to determine what you need. What does your management team say you ought to be doing with regard to outside counsel?

Then I would suggest that, once the evaluation process is started and the questionnaires or the responses are coming back from counsel, you sit down with your general counsel to take a look at the ones who meet your criteria. At this point, I'm suggesting to you that the personal interview is absolutely essential. It's not inexpensive, but it's absolutely essential. It is that time that you get the feel for the lawyer and the personality of that particular lawyer and determine if it will mesh with your people. It has to mesh with your people. Not just with your attorney because this is not an attorney-to-attorney thing, particularly in litigation. What you're going to have to do is be working in a number of areas that the lawyer will be working with. All of the departments that are involved in the process where you're going to deal with lawsuits need to be satisfied. It's important that the lawyer and your management team work together and that the chemistry is right.

Then, the "M," management control should be involved, not only in the selection process, but in cost control. It is not inexpensive. The most significant thing you can do with regard to expenditures in the legal area is that you get your money's worth. Get your lawyer to help you arrive at the desired result and obtain it at a reasonable cost. The lawyer, in most situations, will be working with you, particularly on litigation. He or she will be working with a number of your people. I suggest that broad representation be in the selection process.

The next item is to have a successful relationship with the outside counsel. You should require not just competency in the practice of law and sound legal advice.

Those are two things that are essential. I believe that the lawyer that you choose and the firm that you choose should add value over and above the normal for any client arrangement.

Next is "A," articulate the company requirements. This is the one area that I find many companies do not do well. Make sure that you state your expectations. Set forth your requirements and your conclusions that you've reached as to your needs. Once the selection process is completed, the selectee may very well be able to help you define or refine those needs and wants. But that's something you should be telling your lawyer. They should not be telling you.

Last in this area, I would suggest that the relationship should be broader than attorney-to-attorney. The lawyer and the law firm in all likelihood will be working with a number of your people. Bring those people into the process because litigation is a team effort. It's costly not only to bring the lawyer in, but it's costly for the time that you spend with your claims people, your underwriting department, actuary, etc. What you're doing really is helping to build a team that will win lawsuits. I mean win lawsuits. Not just hold them down, they will win lawsuits.

I'd like to touch on one thing very few people do. You have to ask people about how they're going to bill you. Billing for time is one of the most difficult things that I've had to do as a lawyer coming from the industry. It's an extremely difficult process and it's not a very pleasant one, but it's more pleasant for me than it is for you if you don't know what I've done and why I've done it and what the costs are going to be. The budgeting process for litigation is very experimental. It's more an art than a science. If the law firm knows that you expect it to prove its activity, it is very helpful from your standpoint, and it's very helpful from the law firm's standpoint, because it has a feel for exactly how much detail you want. I would say that the original analysis is to get as much detail as you possibly can. As the trust and the confidence build, you perhaps can then change to a little different approach. The more detail you ask for early on, the better results you will get as far as making sure that it's billing you properly and that it's doing the things it says it will do.

When I was president of a company, I saw often that the law firms were sending out two, maybe three, people on my project. Sometimes there is a need for more than one lawyer or staff person on a case. Often, that's not true. In depositions, arbitrations, and a number of other areas, one attorney is sufficient to do a satisfactory job. If you question these people, you'll get an answer that somehow implies you're in a training program. It's not your responsibility to train the law firms and their employees. So what I would suggest to you is, be tough on the bill and remember that the law business is extremely competitive. Don't fail to negotiate as hard as you can on the pricing.

Another item that I want to address as far as selection process is concerned is, not only should you be talking about confidence, expertise, communication, and good chemistry, but you ought to be talking about who is the actual person that you're hiring. Are they really interested in your company's problems? You can get a feel for this rather quickly. I say it doesn't make a nickel's worth of difference if you pay a big fee to a big firm for a big name. If that person is not interested in your issues, your company, and your people, you're just throwing money away as far as I'm concerned. Make sure that he or she has a feel about your company, your people, and your problems and is truly interested.

Next is "N," nurture the relationship. This is a personal thing. This is a people thing. Bring the lawyer in and expose your people to the lawyer and the lawyer to your people. Your people respond satisfactorily in the case of litigation when they have a comfort level with that individual. A dinner with a lawyer and your key people who are involved in litigation can pay big dividends. During the course of discussion, other activity will be discussed. Bring your lawyer into the company.

Finally, I talk about "D,"documentation. When I went to a prior client, it had just been hit by a significant punitive damage case in California. What I found was area after area that had incriminating files. The underwriting files were screwed up, the claims files were screwed up in that they would say things that were not appropriate. You better have definitive proof in your files. Otherwise, you're going to have a lawsuit; you're going to have a punitive damage case. But you see things like this in almost every company you go to. As an example, "This sad lady is a school teacher and we're not going to get any good information because she's not smart enough to know." And then you take that file before a jury and say, "There's what they think of my client. That school teacher is not smart enough to settle this case." What do you think your chances are of winning that case? Zero. But not only are you going to lose it, but you're going to lose it big. Go through your department and you'll find comments such as, "Maybe we can get away with this or maybe we can do this." Get that stuff out of your files. Correct your files. Correct your policy. Correct your procedures. The best approach, as far as I can tell as defense against the perils of litigation and the cost, is a well-educated, knowledgeable group of people in-house; not so much lawyers outside, but people in-house who are concerned about your practices, your policies, and your procedures and who are aware everyday that there could be a lawsuit tomorrow about this file.

There are many people out there who would like to destroy your companies. I would suggest again, bring an expert in to look at some of your policies, some of your procedures. Sometimes an outsider helps. One last comment is the claims bar, the consumer, the insurance departments, and the courts basically are anti-insurance company. They want you either out of your business or they want a chunk of your dough. So you've got very few friends out there, and what I would ask you to do is, with regard to making friends, make one of those friends, if you can, an efficient and trusted lawyer. It may be helpful down the road. Not just to have your company survive, but to have it succeed like you want it to.

Mr. E. Perry Kupferman: I have a question directed to the consulting actuaries who are here from large consulting firms and from a small one, really directing it and hoping that I'll get two slightly different answers. To what extent do you perceive a conflict of interest? To what extent can you operate both as an actuary and as a consultant or intermediary?

Mr. Knowling: I don't personally work as an intermediary. We do have members of our firm who do that. One thing we do at Tillinghast is we constantly use our phone mail system on a regular basis. We have, day after day, conflict of interest checks. For any kind of sensitive job, conflict of interest checks are done on the company, maybe even particular individuals within that company. A question is asked, "Have you done anything with them in the last three years?" to make sure that we're not playing both sides of the game. We make a very concerted effort not to do so. There are a few minor occasions where it may be that we do things for one company and for another. If we do that, there has to be disclosure on both sides and an agreement between all parties that it's all right.

Mr. Stevenson: In the case of the intermediary, it becomes much clearer. Using an intermediary to place reinsurance means that the intermediary is often paid by the reinsurer. That does seem to create a potential conflict-type situation, or at least unusual if you're representing the ceding company, but you're being paid by the reinsurer. I personally feel that it's very important to try to design compensation systems in consulting and intermediary work to really try to align interests appropriately. Another example that I had was using a reinsurer for product development. That seems like that could be a good alignment of interest. The reinsurer is going to want to develop a profitable product if it's reinsuring it. That's in your interest as well. However, some actuaries will do product development maybe as a percentage of premiums. I'm not sure that's appropriate. The actuary might have some incentive to design a product that does not necessarily produce many profits, but will produce many sales. You want to watch out for that type of conflict. It would just seem to me if you had some situation where you paid the intermediary some type of fixed fee to do the work, but then reward them on a percentage of the savings that he or she could achieve, that would be a much more effective method of compensation. That would hit the small-company actuary budget even though it would be a much better alignment of interest. If there is a situation where the intermediary represents a ceding company and is paid by the reinsurer, the response to that is disclosure.