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Session #65OF
Risk Measurement and Management for Health Insurance

Track: Health, Risk Management

Moderator: Thomas R. Corcoran
Facilitator: John W. C. Stark
Panelists: James E. Drennan
Scott D. Haglund
Douglas W. Taylor

Summary: Panelists discuss their practices and experiences implementing risk measurement and management for various health insurance product lines including disability income (DI), long-term care (LTC), medical/managed care and group insurance products.

MR. THOMAS R. CORCORAN: We have a panel of distinguished experts in their fields. This is an open forum. The session will be led by a facilitator, John Stark, and we have three experts.

The first person I wanted to introduce is John Stark. He's executive director and actuary for Anthem. His duties include acting as valuation actuary and improving and developing models. He's worked for the company for almost 20 years in group, individual and HMO lines of business, and he will be the facilitator for the question-and-answer session.

Next is Jim Drennan. Jim is a principal in the Atlanta office of Reden & Anders, specializing in financial and strategic managed-care engagements. He's worked with numerous insurers, HMO plans, Blue Cross & Blue Shield plans, state insurance departments, self-insured trusts and associations in both the group life and group health market. He's assisted in pricing, reserving, experience rating, underwriting and benefit analysis. He has more than 30 years of life and health experience. He joined Reden & Anders in 2002. Prior to that he was a principal with Tillinghast –

Towers Perrin. Jim will be discussing risk-management issues relating to medical coverages.

Next I'd like to introduce Doug Taylor. Doug is second vice president and CFO for MassMutual's individual DI and LTC lines of business. He's been in this role for a few months. Prior to that, he oversaw all the financial functions for those products. Before MassMutual, Doug had various actuarial and financial roles at both GE and various incarnations of UnumProvident, in the United States and Canada. Doug will be discussing issues relating to individual LTC and DI.

Our third expert is Scott Haglund. Scott is an actuary with the Principal Financial Group and has been involved with pricing and valuation of both individual and group disability for 18 years. He's presently involved with pricing and valuation of group long-term and short-term disability at Principal and will be our expert on group disability issues.

MR. JOHN W. C. STARK: The session will be pretty much interactive. Each of the experts is going to talk for about 10 minutes to give you a sense of what they do at their companies, and then after that we'll want questions from you. If you don't have questions for us, we'll have questions for you. One of the things I wanted to mention is I'm head of the Health Risk Management Subgroup of the Risk-Management Task Force. If you want to get involved with this in the Society you can just give me a call at my yearbook address. We're always looking for volunteers. We'll get Jim Drennan up here to intrigue you with what they're doing.

MR. JAMES E. DRENNAN: We're going to talk first about health insurance, which may be a majority of the people in here but a lot of these principles overlap into other areas. The point I want to make right off is the risks are real, and we want to talk about what those risks are. It was brought home to me a little more clearly this week than usual. I experienced a non-work-related risk. I was playing racquetball, and I was hit on the side of the eye. I didn't have my goggles on for some reason — I always wear goggles — and I thought, "I need a little bit of risk management in my racquetball game." Thank goodness I only have a little bit of redness in the eye and it's cleared up, so I was lucky, but the risks are everywhere. In the health industry, the increased litigation by providers is well known to all of you — things like the physician fees. This is very similar to the tobacco lawsuits where the lawyers seem to go in and start rummaging around, trying to find something that they can do a class-action lawsuit related to. In court rulings, we've seen some individual large claims, such as the people who spill hot coffee on their laps after they buy it at drive-through windows and win lawsuits. There are broader lawsuits, too, such as the Americans with Disabilities Act being expanded in some unusual areas.

Consumerism is a concern, but it seems like something that we have encouraged. We have these consumer-driven health plans, and we're pushing consumers to try to take a more active role, but in some instances that will backfire on us and it will

cause much more of a risk if they start to really be proactive. The state and federal political environments are definitely changing. If you were in the association health plan session yesterday, you could see some real changes in those environments, related to the compliance with the regulations and Medicare statutes, HIPAA and all the state regulations. Those are all significant sources of risk.

Generally, we will talk about the core business foundation. We will start with quality of care, which sort of leads to the reputation, then financial results may deteriorate, then relationships and then sales. They're all related, and that's a common theme you'll hear today. I have an example for quality of care. In *The Wall Street Journal*, I think Tuesday of this week, maybe on Monday, an anesthesiologist had given a shot in the wrong area of a person's body during surgery and the patient almost died. The patient and his wife were about to sue. The anesthesiologist in this article went and apologized to the patient and the patient's spouse, against the advice of lawyers, I'm sure, because they recommend not doing that. The people decided not to sue because they realized that he made a mistake, but this quality of care really is an issue. We're getting much more involved in the risk of that and those things flow through the whole company.

A common theme also is how can we turn these risks to advantage, not just being defensive, but being more offensive in some cases? In general, most enterprise risk-management has focused on the center section — the center floor, the marketing operations, medical, clinical and finance. As actuaries, we tend to look toward the financial parts. Organization strategy, performance and people management have not seen as much activity. For example, there is the organization strategy. Should your company be looking at a merger or an acquisition? Should you look at market changes and try to come up with new products? Those are risks, but they're also opportunities to move ahead and stay ahead of the market.

Next, I'll define the risk types. Point of sale is one. In the medical area and in all areas, there are financial incentives for the physicians. You may also have undisclosed management decisions where there is an incentive for the physician to do less work. He gets paid more if he does less, getting fees on some sort of a capitation; those have been a source of risk. Another area is discrimination in your pricing — actions by the company or unfair trade practices.

Point of service is the second area, such as the medical service in this case. You can have adverse outcomes due to negligence. Again, I go back to my example of the anesthesiologist who apologized. Perhaps here we should have a new position called "vice president of apologies" or something like that. You need to have some definite action and controls for these. You can have inflated reimbursement recoveries. You can have discrimination in your peer reviews or your rating for doctors. These are all at the point of service, where the service takes place.

Then there are the managed-care aspects. As the claims are being processed, you have the cost-saving protocols. You have the fiduciary responsibilities where you may not pay a claim because you have some economic gain in the insurance company, but that may violate some responsibilities in your contract. There are inconsistent protocols and improper denials of benefits. These are often due to an overzealous staff. You may have your staff being really incented to control costs, and they may go further than the contract allows and you wind up with some real risk there.

We mentioned the physician litigation earlier. You may have contracted with the physician, and you have some fraudulent representations. Maybe you shift the risk through a capitation, and the physician doesn't really understand it and suddenly they become bankrupt or near bankrupt. You can interfere with their care (at least the doctor will always say that you're interfering with the care, that's a matter of point of view). Slow pay and discrimination or exclusion from a panel are other areas. However, the exclusion from a panel may also be a control of risk. If you want to take doctors or hospitals that are not quality that may be a point where you control your risk.

How do we put that together in an assessment? Charts 1 and 2 illustrate this. Across the top I have these areas: the point of sale, point of service, managed care and physician litigation. They're broad areas; you can make different cuts, but this is what I've done. I've laid out down the left-hand side your organization, your marketing and your operations. Each one has its own issues. In the point of sale on the far left column, you have the accuracy of disclosures, fairness of sales practices and so forth. These are the risk maps. This is where your risks are so we've tried to break it down into smaller pieces.

We talk about medical management, finance, and people and performance. For instance, under people and performance you have whistle-blower, discrimination and consistency. I won't go over every single box because they'll differ for different companies. This is just an example of how you would evaluate your risk map. Where are your risks? Then you say, "What do I do about those? What's an action plan?" Let's take the same scale, the same boxes, but we have some possible actions. For instance, for physician litigation, you will ensure admissions are consistent and appropriate and manage the network and credential processes. Again, for each column, you have some things you can do.

The center one is point of service. Transfer the risk by outsourcing customer service. That may transfer some risk, but it may add some cost, so there are offsetting things. There is more than one approach to handle the risk. The key thing is to lay it out and understand that these risks overlap and they're broad. They're not just looking at your reserves or your pricing; it's much broader than that. Going further, this is again part of the action plan. As far as finance for physician litigation, you can provide insurance to help physicians finance the risk. That's been done in the P&C area for their directors and officers (D&O) type of coverages. This

is another possibility. By taking that action you may help the physicians, keep them happier and avoid some risk. They'll leave the network. Have you ever been to a doctor who talks poorly about your network? That's not what you want. You want the doctor to be happy because he has the direct contact with the patients and that really can hurt you if you do have an unhappy doctor. He might say that they're slow to pay and they're the worst payer he has. I had one like that. He said, "Oh, that company is terrible. They don't pay me well at all." So why are you in the network? That's what you want to do. Then you can audit their creditworthiness. There are different options. You can transfer risk by outsourcing benefit payments. Again, there is the cost, but there are ways to handle the risk.

Let's take my example of the racquetball and see how we would apply this to a real-life situation. For point of sale on our racquetball, I should buy some good goggles and buy a strap on the racquet. That's the point of sale. Next is the point of service. When you serve in racquetball, you should serve so the ball doesn't wind up right behind, you putting yourself at risk for the guy behind you hitting you in the head. You should serve it in the corners. That's an action plan.

Secondly, you shouldn't turn around and watch it, which I did. For the managed care aspect of it, you should try to get your network of players to be guys who are not wild, hard hitters who are going to hurt you. This is similar to your network of physicians. You want to control your networks. This is applicable to your real life. On the litigation side, you probably should have a release signed with everybody you played. That's probably true, but even better I play with a doctor, so then I have a guy there who will help me out if I have a problem. These are real-life things that you can apply in the medical area and in other areas.

MR. DOUGLAS W. TAYLOR: I'm going to talk to you about DI and LTC. I'm going to talk about how MassMutual has approached the whole enterprise risk management concept and how that's worked its way down into the lines of business I work in. Things started at the enterprise level probably a year or so ago when our chief actuary went to the president and said, "Bob, you know, I think we need to embrace this enterprise risk management concept that other companies are doing." He said, "Good idea. I'll make you the senior risk officer."

Being in a large company, nobody can do things alone; you have to form a committee. He formed a risk-management committee, which consists of people including the CFO, the head of audit and the valuation actuary. It now includes the chief information officer and the head of human resources. He has a committee of people that meet with all the different lines of business and all the corporate units.

When Tom called to invite me to perform on this panel, it was pretty timely because we had just put together a risk-management report for DI and LTC. Enterprise risk-management is considered an ongoing process at our company. It's considered to be an umbrella supplemental to all the line of business and corporate unit risk-management practices. When I think of risk management and the lines of

business I work on, I think of underwriting, claims, product and pricing. This goes beyond that. It's not just making sure we're doing all that stuff right; it's making sure we're thinking of all the risks that could affect the lines of business.

The risk committee is trying to make sure everybody is more aware of all the risk-management concepts, and it's an evolution. They're looking across the enterprise for compounding risks. They're also looking for offsetting risks. A simple one would be if you sell both life insurance and annuities, the longer people live, the better for life insurance. It's not good for annuities, but those are good offsetting risks. They're also looking for opportunities where maybe there's pretty heavy risk in one line, but that risk is an opportunity for another line of business. If you pair the two up, you can grow both lines and be offsetting of each other.

They're looking to create a database of all the risks and try to understand what's there and piece that together. They're going to be adding risk metrics to management reporting, so, again, over and above what lines of business are doing now. They are also looking at having the senior actuaries of each line of business also be the senior risk officer for that line as well.

In terms of DI and LTC, when we put together our report, we were given the assignment: identify all your risks; identify your controls and gaps; what you think the probability of this risk occurring is; how severe it could be; and what would the total impact be. We were asked to then rank our risks based on the total impact and present that. So we had a nice table from top to bottom: Here's what we think all of our risks are and all that goes with it. They also asked us for our opinions about what our enterprise risks were and what opportunities we thought there might be, so we were allowed to go outside of our own line of business to tell them what they think they should be looking at.

In terms of risk for DI and LTC, some would say that probably the biggest risk is just being in these lines of business. There aren't many companies left. It seems like a lot of companies have exited DI, and LTC is under heavy consideration right now. I'm going to talk about several of the different risks that we keep an eye on within these lines of business. I broke them out between what we can try to control internally versus what is facing us externally. Of course, the biggest thing for us both in the internal and external side is morbidity. If you mis-estimate morbidity, you're in trouble. For morbidity management, you have to walk a fine line between giving away the store and being full of class-action lawsuits and other litigation.

Pricing is a risk. You have to get it right. You're either going to be too competitive, sell too much and not earn enough profit, or be uncompetitive and not sell anything at all. Persistency is a risk, I'd say particularly in the LTC line. In every LTC session I've been to, everybody talks about how companies thought the ultimate lapse rate was 4 to 5 percent; now they're seeing it under 2 percent. Obviously, that's a big thing for a product like that where it's a lapse-supported product.

Sales and mix of business are very important. You don't want to overdo it in any one market. The disability business itself has paid heavily for overselling, for example, in the physician and dentist market in the 1980s and 1990s. Because they were overconcentrated in those markets and those markets went bad from a disability perspective, it really hit the industry pretty hard.

People are a risk. At MassMutual, we take succession planning very seriously. We want to make sure we don't have gaps. It's gotten to the point where if somebody wants to move on in the company, he has to have somebody ready behind him to take his place or he's going to be held back until they do find that person.

One of the key risks we're looking at from a people perspective right now is that we're moving one of our offices 20 miles up the highway. That's created a lot of anxiety. Are we going to lose this person? How are we going to get them to go with us? That's one of the things we're facing during the next year or so.

Next are financial controls. I'm sure most of you heard of these two guys named Sarbanes and Oxley, in particular Section 404. Even though we're not a public company, we're still going to be following what other public companies do so that we have our standards in line with everybody else. This is a good way to identify risk not just from a financial reporting perspective, but anything that could impact your financials, whether it's today or five years in the future. In fact, in our Sarbanes-Oxley work we included things like the underwriting process and the rate-setting process because if it doesn't affect us today, it could affect us in the next few years.

With technology, there is reliance on things like Legacy mainframe systems and outside party reliance. If you're using outside vendors, if you're using third-party administrators and they go belly up, you're kind of stuck.

On the external side, keeping an eye on morbidity drivers is important — not just stuff you can control through your underwriting and claims practices, but stuff that could affect you in the outside world. What the competition does is very big. Regulatory is obviously very big. The economy can hit us in a couple of ways, both in terms of morbidity and interest rates. If your two sources of revenue are premium and investment income, and the interest rates aren't what you price for, you have a problem. Demographics are a problem. If you have shifting markets and you're not ready to underwrite those new types of markets, you could run into trouble as well. This is not an exhaustive list, but I wanted to discuss everything that came to the top of my mind and I think we have in our report, which is not available for publication.

MR. SCOTT D. HAGLUND: One of the first risks I thought about yesterday was speaker risk. Yesterday I was reading through *The Wall Street Journal* and they were talking about how, during meetings, the vast majority of the people are getting their personal lives in order. You're thinking, what do I have to do when I

get home? What things do I have to buy? What do I have to do back at the office? So that might be the first risk I would talk about: speaking at these things and what everybody is actually doing out there while I'm speaking.

Some of the risks I'm going to be talking about are going to stay fairly high-level because there's just a ton of risk to manage. That's any enterprise. I think there are some risks that maybe five or 10 years ago we wouldn't have anticipated. Doug talked about the Sarbanes-Oxley stuff, which makes all the sense in the world. There's a tremendous amount of documents and paper that is moving around now to help manage that risk and control that risk. Similar to MassMutual, we have manuals of stuff for all of the processes that internally we have going on to say you have to make sure that you manage these types of risks.

Even terrorism itself is a new risk — not just the act of terrorism, but we have training classes on money laundering and the terrorism acts that are going on now. There are even new risks that are introduced. Granted just the act of terrorism is significant, but you also have the things that surround that. There are a lot more risks to be managed now than maybe there have been in probably almost decades with all the things that are going on.

I'm going to talk briefly about a few of the risks. Some of the obvious ones, like pricing, the organization itself and some financial risks are the main topics that I'm going to touch on here.

In terms of pricing risks, some of the obvious things for morbidity are incidence and termination. I wouldn't say it's easy to set incidence and termination, but we can feel pretty comfortable that we have four claims per 1,000. We think there's a 20 percent chance they're going to recover during the certain duration. I think the biggest struggle in terms of managing risks is how closely that matches to how your financials are coming through because you've set a pricing assumption. It may not even be remotely close to how you're reserving if you're doing a GAAP or statutory basis. If you're looking at how things emerge, even though you can feel comfortable on the pricing side, what you may find is that in the tail life of a policy you have 3 or 4 percent return on equity (ROE) because of the mechanics that you've set up. You're front-ended with all the profits; things happen on the tail end. So the biggest thing in terms of pricing risk is how are you going to measure that? Does it mimic at all how things are materializing within your company, within your financial statements?

For stocks and even mutual companies, there's a lot of explaining that has to go on to say, "We're profitable. We have confidence that we're going to get income back the way you guys expect it." In incidence and terminations, do you look at something by lives? I think there have been some articles that talk about doing reserve-weighted types of things, so just how do you measure it? Do you look at your pricing assumption, some type of industry standard or just flat out go to your reserving assumptions and say this stuff should be in sync? I think a lot of the

pricing risk is really a matter of measurement to make sure you're measuring what you're priced for. This sounds pretty simplistic, but I would be surprised if everybody is actually doing that. You may be measuring something, but it may not be at all what's coming through in the financial statements.

The last thing would be expense levels, which are fairly significant too, but that is a big pricing risk. Recently, with all the 401(k) and the pension plan funding issues that have come across, there was a fairly significant cost to a bunch of insurance companies and companies across the board. Probably a lot of expense pricing that you had in place would not have anticipated a benefit cost at that level within your organization. It's one of the things that can change fairly dramatically. It's probably more of an issue on individual disability, at least on the non-cancelable side, because with that structure you leave rates out there for good. But even on the group side, if you don't refresh your expenses often enough, you will find that you're going to come up short pretty quickly if certain benefit costs within your company have changed dramatically.

Again, more on the pricing risk side is finding pockets of concern and pockets to target. You may have unintentional pockets because one of the common statements is that mistakes sell. Things you do right might not be the things that sell, so you may be targeting things that you're not aware that you're targeting. That is a pricing risk to say that somehow someone -- a broker, a sales rep or anybody -- found something that's deficient within your pricing. Or there's something your underwriters look at differently than other companies, which might not be a good thing. Once in a while it is, but it may be an unintentional thing.

Again, you need to find the financial as well as the pricing impact. For example, you might price on a lives-weighted basis, but the financial impact might be on more of a benefit-weighted basis, so you get two different answers depending on how you want to look at what's going on on the pricing side.

Does the rate being charged match what's expected? Are there errors, adjustments or case characteristics different from assumptions? Again, that's a fairly obvious thing, but to price anything, there are a lot of assumptions. LTD, I think, might be one of the biggest offenders of most of the products in terms of having 40 or 50 adjustments onto what's turned out to be a fairly simple process. We've complicated the heck out of it. To say we're getting back exactly what we expected might be a difficult thing to state.

Next are organizational risks. You can look at the impact of the underwriting organization. How are they adjusting things? Are appropriate decisions being made? If you look at some of the experience-rated business, are they actually adding value to the financial picture of the organization? It's one of the risks that can be managed to some degree, but a lot of companies might not be aware of that. If you start experience rating at 50 lives or 100 lives, would you have been better off charging your manual rates instead of having an underwriter touch the case? If

they lower it or adjust it inappropriately, you might have actually been better off to say, "We don't want to look at credibility. Let's just charge for your manual." So there might be certain things like that going on that people aren't aware of.

What's the impact of claim decisions? Is the contract being administered just like you expected it? Do you have claim procedures that are outside of the contract that they're administering? It's not contractual, but that's how they're operating. How does claims backlog impact things? There's also the presence of other coverages. There are certain decisions being made because something else is present, which also comes from the organization, but impacts quite a few things.

How does the distribution channel impact in your organization, impact in the risk? It could be difficult to manage, but again, it's more just knowing what's going on. Do you have Internet distribution, general agents or through large brokerage houses? The risk depends on how things are getting sold. There are also certain people who you can easily look at and say there's something going on with their block of business either positively or negatively. That's a risk that can be looked at, and you can be more cautious about certain people. There are a lot of measures. There are the typical ones — loss ratios, close ratios and persistency — but they can be looked at on an underwriter basis. They can be looked at on a claim examiner basis for some of this stuff. You can also look at it by the brokers and by the sales reps. I guess there a lot of different measures that are out there.

Some of the financial risks include equity levels. How much strain are your reserve assumptions putting into the business and is that appropriate? Do you want your GAAP reserves and statutory reserves to be equal? To eliminate strain, you might have some better ROE patterns that come through. And now with S&P and Moody's coming out with their interpretations of what appropriate equity levels are, it's different than what the NAIC used to have, so there are a lot of different measures that are going on now in terms of equity.

Next is appropriate reinsurance protection. For some companies that might be essentially none. Again, if you think you're selling profitably, you might be overinsured. You have too much revenue that's going out the door to the reinsurer. But again, if you have smaller case players, you may want heavier reinsurance, so the biggest thing is just if it's appropriate or not.

How are the earnings emerging? We've seen some reserve buyouts where you might have a high — 30, 40 or 50 percent — return in the first year, but then in the future years, it's more like 7 or 8 percent. For shareholders that might not be a very attractive proposition in the future years if it's a large enough buyout to say: Why would you invest in that future earnings stream? Internal rate of return might be just fine, but if you're measured on an ROE basis, they're two different things. Somehow, if you look at levelizing the emergence of that, either through deferred acquisition costs (DACs), or, again, reserving assumptions. There are a lot of ways

that you can get things to come through more of how you expect them to on a GAAP basis.

Next is emergence of expenses. I think group carriers are a little bit more mixed on that, at least in LTD and STD. Your first year and renewal expenses are different. If you don't DAC, you're really depending on that you're going to have about the same mix of first year and renewal business throughout the life, so you haven't made an assumption on that. If you go through a huge growth spurt you may see that mismatch of expenses. That points to either you have to DAC or you have to be a lot more diligent on refiling rating annually at least, if you're not doing that already. I know, in terms of being involved with rate filing, it's not a desirable position to go through the pain and turmoil annually, but that's what that points to. If have a changing dynamic, you have to price for it.

MR. STARK: I have a couple of additional comments. It seems like the health area is a little further behind than the life and P&C folks. It seems like we've started to catch up now (the number of people we have in this room who have some interest is an indication of this), but we really do need to get involved for several reasons. There are huge differences between health, life and P&C. I don't have to state the obvious, but it seems like an appropriate time.

One of the problems is that we have life and P&C regulations applied to us. Think about health risk-based capital. All of a sudden risk-based capital came in, then there was a task force with Bill Bluhm to develop the health risk-based capital and make it more appropriate for us. I just had to fill out an asset-adequacy opinion, because we do the blue blank and the laws say you have to fill out an asset-adequacy opinion. It was an interesting exercise. If you filled out one would you say that this indicates the solvency of my company? These things can lead to a false sense of security for people and focus you on things that really don't help.

Another thing to think about is the risks imposed by Wall Street. I worked at Blue Cross of Virginia when it was Blue Cross of Virginia, and I've seen going from nonprofit, demutualization to public company. In some of the sessions we talked about the strains Wall Street put on us and that is another risk, trying to meet some of the goals and whether they conflict with what you really want to do.

Sarbanes-Oxley is very interesting, and if you think it doesn't apply to you because you're not a public company, the NAIC is starting to look at a Section 404 type of statement for everybody. Are most of you aware of that? We have all kinds of people commenting on it. American Health Insurance Plans (AHIP) is commenting, as well as the Blue Cross Association. I'm not quite sure if the Academy is. Some of these things that are coming down the road you just need to be aware of.

MR. MARTIN E. STAEHLIN: I'm going to invent a term. I'm going to call it "risk elasticity." Jim Drennan had a slide that said, "Actuaries really need to get into strategic planning." I think our keynote speaker focused on that also, saying, "I'm

in health care all the time and I never see actuaries." If what a company needs is some actuarial insight, how does the panel see actuaries getting involved in strategic planning so we don't appear to be at a higher level of worrying about what the risks are and helping companies move forward in actually planning to manage these risks? So you evaluate all the things you guys talked about, but then take a step back, and say, "Now how are we practically going to get through these problems?"

MR. STARK: One thing I think I see, Marty, is often the actuaries don't get involved. You're asking how they should get more involved. I think if your company is talking about enterprise risk management, you should definitely push to get on a committee or be involved with a committee. Secondly, you should probably do some independent thought and maybe provide some comments. For instance, actuaries tend to look more into the future than other people who are in the company do. Can we use that to say, where do we think the environment in health care is going for whatever products we're in — disability, health? Then we could do some brainstorming maybe independently, like, whether we should be looking at just getting out of the line of business or getting in new lines of business, buying a company. Then you could take that to the risk officer, to the committee and try to be proactive. This is not an easy answer. There's no one way to do it. Proactive is, I guess, the best term. As you said, the actuaries aren't seeing much. We tend to stay in our little cubes in our offices, and we need to get out.

MR. TAYLOR: I'm very heavily involved in our line's strategic planning process. I've been involved in pointing out the current situation internally and externally. My boss has said that we should have aggressive top-line and bottom-line growth goals. I'm heavily involved in telling her how we can and can't get there — kind of laying the constraints and groundwork for how we achieve the strategic plan goals.

MR. HAGLUND: The biggest struggle is within pricing areas, valuation areas. They very much would understand or think they understand what's going on. I don't know how often any of that is communicated outside of the actuarial realm. For example, if you notice problems in underwriting, it sounds simple, but I think the biggest thing is you talk to underwriters and say: These were the risks that we're identifying and this is what we think you can do about it. I think it may be a more unique position only because actuaries typically see more of the organization than what some of the other functions do. You see claims, underwriting, sales, expense-management and a whole bunch of sections of the company, so you do get a very good, high-level view and maybe see how the pieces coordinate. It probably goes beyond just pointing out what's going on.

The biggest thing to point out is why it's happening. I think in terms of strategic planning, even without being on the official committee. I think one of the biggest functions is maybe not just to point out the problems, but also with the problems to point out this is how we think it could be solved. Or ask whatever functional area it

is, this is how it can be solved, so it may not actually be strategic but it can assist the people who maybe are making some of the strategic decisions.

MR. STARK: Let me add an example of exactly what you said. I had a client who was allowing open enrollment all during the year. People could switch between products. This was a small group, which is really a high risk. I did not ask the right questions. Once I realized it, I pointed out that that's a very costly thing to allow people to come in and out, to change. Normally, you'd allow them to change on life changes. They were allowing it at any point in time, even, say, if you heard you were going to have some surgery. They weren't enforcing preexisting conditions either, so that was a double whammy. The point is just as we said; we need to be proactive and to ask what's going on, to look at other areas other than just actuarial because we can help evaluate those risks and point them out better than some other people.

MR. CORCORAN: I would just add one other perspective. I think risk management is a new field. Actuaries need to be able to force themselves to get outside their comfort zones. It's an area that's going to be new to everybody, not just actuaries. Actuaries have an awful lot to offer to the solution, but a lot of the solution is going to be from people who do step forward as opposed to waiting for people to come and ask them. I think in MassMutual Doug indicated that that was the genesis of their program — the actuary stepped forward and said they really should be doing something.

MR. STARK: A lot of this is cultural. It depends on how your company views actuaries. Do they view them as technicians to be tolerated? Do they view actuaries as a resource? Think about that as you're going through this. This leads into a pretty interesting set of questions. Since it's a new area, and it's the new buzzword, guess what? Everybody wants to stake out some turf. If you start looking in some of the literature, the accountants want to be in there. The auditors want to be in there. You have groups like the Global Association of Risk Professionals (GARP) and Premia that have risk professionals that have already been there on the asset side. One of the things that the actuaries need to do, just to echo Tom's point, is to get out of their comfort zones and start stepping forward. It's not as if someone's saying, "Let's wait on the actuaries because I'm sure they have something to offer." You have people that are saying they're there and they're ready to manage your risk.

Now, how many of you think you could be chief risk officer? Good. How many want to be? Good. Let's put it another way — if not you, who? Who would you think would be a good chief risk officer other than maybe the chief actuary? Does silence indicate you don't think anybody would do better?

FROM THE FLOOR: When Doug was talking, it surprised me he didn't include the traditional P&C risk manager at MassMutual, who is worried about buying the general liability and buying the D&O. I always thought most companies' chief risk

officer is this former insurance person who became risk manager and now he's the chief risk officer. How do you contrast what you're referring to or the relation to that kind of a guy, being the chief risk officer versus the actuary and all the risks you're talking about?

MR. STARK: That's one aspect of risk management, and you're right, that's more the P&C aspect where you have your D&O and your workers' comp. This is much more an integrated view of things. This is where the actuaries really do shine. Maybe you have two departments. One manages a certain aspect of one risk, and that's his whole reason for being and he does a great job. Another part of that risk may be managed or dealt with by a second department, and it's just part of their duty. So here you have a risk — one aspect of it well managed, another not. Would that worry you? What are you going to do about it? And that's where enterprise risk management comes in because it's a very holistic view of things. You want to look at processes to make sure that if a certain risk is important, it's important to everybody. That's the kind of thing you're talking about.

The other piece we talked about is the people risk. Remember Berings Bank? Nick Gleason brought it down. Do you think that could happen to your company? Well, I bet they didn't either. You talk about underwriters. You made a great point about open enrollment all year, the way you sell business. You might have forgotten something and somebody has picked up on it. People can really damage you and not just upper management, so that's another thing.

Credit risk is a real opportunity. Do you measure reputational risk? Do you watch out for it? What kind of risks do you measure other than the traditional ones, or do you? Reputational risk is a very good example. This is something that actuaries normally don't worry about. However, it affects your company. If you get into trouble and your company is being abused on all sides, especially if you're a health company and you deny cancer treatment or experimental surgery, all of a sudden you are fighting for your life. What happens? Usually in an emergency it's all hands on deck. Then who's running the business? One of the problems there is, if you don't have a contingency plan, you're going to have people trying to fight off lawsuits as well as trying to run the business. All of a sudden, the secondary effect is you might lose market share. Do those get considered in your company? Do you have tools or techniques or plans to deal with that?

One of the things we do, and I've heard this in another session, is print out tables to the third decimal place. Sometimes it just makes it look nice, format-wise. A lot of what we do is estimates, so depending on what you're doing there is not that precision. For reputational risk, you could develop an indicator like an arrow up or down or something like that just to say that we need to watch out. It doesn't have to be a stochastic model that takes every scenario into account. Those are the things that we can do, provide some value and say if your reputation is in jeopardy here's how things trickle down. We are in a great position.

MS. BECKI M. HALL: It seems like we've done a very good job of being able to identify the risk and being able to measure it out, but the one thing that we really haven't touched upon is the specific management of it. (Outside of the obvious, the pricing risk, which is what we're trained to do.) I'm in agreement with all of you. The actuary is in a good position to be that sort of risk-officer person, as long as that actuary can be cognizant and understand the different pieces of the business that make up all of those risks. He has to be able to coordinate that, bring that together and see what the actual overall impact is when you're combining all of that. That's what I think the key is for that risk officer. You do have to be reliant on those who are in those particular areas of expertise for those pieces of that risk, but I think I would want to hear more about going forward. How would we successfully manage this? Since this is new, we haven't really focused upon the whole futuristic management of that.

MR. STARK: This leads into a fairly interesting aspect about getting started. There are a couple of things to do: risk policy and risk appetite. What is your risk appetite at your company? Has anyone defined it or is it, "We want more market share; we want lower rates." How do you do it? You need to have a risk appetite, and then off of that, a risk policy that you follow. How many of you have had the large group sales folks come and say, "I have this huge case, but we need to knock a couple of percent off. Just this one time." Of course, if you're like me, you roll your eyes and you go, "Just one time this week, right?" Who keeps track of that? Does anybody? Do you have a sense that after 12 months you've done this about a dozen times, more or less, and that all of a sudden you think, I wonder what we just did?

Developing a risk policy off the risk appetite of the company is something that should have you tracking that and should have everybody thinking about that. Off the risk policy, you can put in processes to deal with that. There is no right or wrong risk appetite. If you set it, then you have to have policies to govern it. You can take on more risk; you just have to know what you're doing. You can be a risk glutton, you can have a nice balanced diet; or you can be somewhat anorexic if you want. You just have to be able to manage it.

Another aspect of it is you develop a risk mapping. Map out all your risk. Rajeev Dutt is part of the health risk-management team. His group developed a risk mapping that's out on the Risk Management Task Force Web site and it takes a lot of the things that the speakers have talked about, defines risks and talks about different aspects of them. That's a real important thing to do. You have to know where you are before you can move forward. Part of that would be a risk inventory, which includes your risk and your risk-management techniques. Who do you have reinsurance with? That's really how you start off. As actuaries, normally we like to wait until we have it nailed down. Just do something — start the process and things will start to fall out for you.

MR. DRENNAN: I agree with John in terms of risk identification, because there are a lot of risks that exist if you had nothing at all in place. I think the biggest thing is

first to understand where risk can get introduced because obviously you can't manage something that's a surprise. Some of the risks may be obvious; some aren't so obvious. You look at who the decision-makers are and if there's succession planning. If this person leaves, who is going to come in behind him? That can be a fairly significant risk if he's a major decision-maker within the organization. Let's say you have one medical actuary and if that person leaves you have no medical actuaries. That's a very significant risk that no one may be planning for. Is there a set plan?

But beyond that, in terms of risk identification, it really is looking at every process in the company, which is time-consuming. You talk to all the claims people; you talk to the underwriters; you talk to the programmers; you talk to the field; you look at all the rating applications. For underwriters, if they have some flexibility, the ability to modify some risks that are coming in, what can they modify? That can be a fairly significant risk and all of a sudden we would point out that's something we have to start tracking or managing better. Or if you look at the claims people, what fields are automatically filled in for them? What do they type in by hand? For example, with LTD reserving, if dates of birth are wrong, somebody puts in 1800 instead of 1900, that's a pretty significant difference, but it can happen if someone's manually typing the stuff in.

In terms of identifying risks, I think there are huge risks that are out there that aren't just people; a lot of it is process and programming, like Excel spreadsheets for reserving. Have you actually examined every single cell within that application? Someone could have hard-coded a number that you're not aware of. How many thousands upon thousands of cells are out there? That does show that there are risks in how you do things as well. If you choose Excel versus another type of software package, there are some risks if someone messed it up and you find it out five years later, but in that interim there was a lot of stuff that was going on until that problem was found. I think it's very tedious to find them all, but once you do find them I think you can at that point check them off one by one to say, "OK, to manage this risk, this is what I'm going to do." It may take a year or two years. If you really start from ground zero that's probably what you're looking at. It's not going to be something that you'll do this weekend and say, "I have all my risks identified and I'm ready to manage all this stuff now."

MR. JUSTIN N. HORNBURG: It certainly is good to be thinking about all these things. There's risk everywhere, in every aspect of what we do. I find myself sitting here thinking that you could have everyone in your company dedicated to this. It would seem to me that you shouldn't worry too much about really coming up with a quantifiable measurement. Maybe you should just rank the risks so that you're dealing with the things that are most important first. How do you balance going back to doing your business, plus spending all your time worrying about all the risks you have?

The final thing I'll throw out is that you probably can't anticipate all these things. There's going to be something that's going to slip through the cracks, a risk you never would have thought about. Who would have thought people would fly planes into buildings? There probably were some people who thought about those kinds of things. I think maybe the best single thing that we can do to control risk is to have good people who can deal with emergencies, crises or risks when something is actually presented — when something goes from being a potential risk to a reality of a problem. Having good people to be able to deal with those problems may be the single best thing that you can do to control risk or at least manage it once it comes up.

MR. STARK: You're right. This is not to make everybody paranoid about risk. It's more an awareness and vigilance because if you have a chief risk officer, if you have a risk culture in your company, there's just more of an awareness of the consequences. Even though I'm incented to do this and my bonus depends on this, what if I do this?

The other thing that would be nice is to have everybody in the company aware of risk. Our whole reason for being is to accept risk, so we have a very interesting way of making money. Wouldn't you like your claims processors to understand what we do in terms of the business, that it's based on risk and that they need to be aware of some of these things? You're right, the whole idea is to rank the risks, but you need to at least to keep an eye on them. You bring up a point and somebody says, "Oh, that will never happen." And then it does. It's trying to rationalize some of these things away that gets us in trouble. Just make it visible and keep an eye on it even if you think it will never happen.

MR. CORCORAN: I think there's another way of putting things in context. The idea that you think about risks and classify them helps you, whether or not that's a specific risk that does occur. If your company may have done fire drills, that discipline will help you in a wide range of scenarios, not just if there's a fire. I think that type of concept is where risk management is heading. If there's some catastrophe and you can't get in your building, do you have backup systems in place? Those are some of the common risks that people have already. It covers a wide risk of scenarios. You don't have to think of every single thing.

MR. HAGLUND: It's not so much management, because my preference would be that you prevent it from happening in the first place. For example, if you can't get into the building, I would say we can have a contingency plan in case we can't get in. But my preference is we keep the doors open. In that sense, I would be concerned if we were spending all of our time managing risk because to me that would say that someone didn't plan it real well here or someone did not put something into place to prevent this from going on in the first place. I would not want to spend all my time frantically fixing things that have gone wrong. You can look at that and say that's what risk management is. I'm going to manage risks, and we'll have very great plans when things happen. But I would turn it around a

little bit and say that the primary goal should be I want to make sure it never comes up in the first place so I never have to deal with it. None of my contingency plans ever go into play because I prevented this from going on in the first place. It's kind of management, but I want to say it's more risk prevention than risk management.

MR. STARK: I think in terms of putting together contingency plans as you look at risk you can say that a certain type of risk is basically a step function. I mean when it happens, you have no time. There are others that, as you monitor and they appear to become significant, then you have time to develop plans. Really there is some leeway in that.

The example I see most often is when a line of business or a reinsurance agreement goes bad, everyone starts pointing fingers and saying we should have evaluated the risk before. But after the fact it's too late. That's the tough one to see in advance because you have a new product and there's some special deal or some reinsurance agreement or line of business. One example is where the legal climate was redefined after the fact. The Department of Insurance said, "No, you shouldn't have done that." They didn't tell you in advance; they told you after the fact and you get a lawsuit or something. Those are tough. It's easier, I think, to see or to evaluate risks as you're starting something, and you say, "We're going to buy a block of business or we're going to do something new," and you evaluate them. It's harder to find those that are already in existence. That's where you'd have to have a culture within the whole company of thinking about it as you go forward, about something that's already in place. We tend to ignore those things in place, and we look at new actions.

MR. CORCORAN: Here are some examples of risk-management techniques that have been put into place. In consulting firms, Jim and I worked together. One of the things that we came up with was an independent peer review of all the work we do. We found enough mistakes in our work to say that we decided it made sense. For every job, you had somebody go through it who had nothing to do with the job to make sure things didn't stand out, that you didn't get too close to the work that you missed things. It seems like a simple concept, a very effective risk-management concept.

Another thing you mentioned was seeing how many rate concessions people have made. Several of our clients have put in bill-to-manual-rate studies. There are other types of controls that say how far off we are. Can we put in a metric that will allow us to tell those types of things? Once you've identified those and come up with a metric, putting something into place to measure those is very practical. It can go from the soft things to things that are pretty well defined. We do see these all the time. It's a matter of thinking about it in a more structured and disciplined way. The process alone allows you to put these types of controls in place.

MR. STARK: Yesterday at the risk-management overview, Sudha Shenoy gave the perfect storm analogy. Basically what this is, if you're identifying risks, you may look at your lists and go, "Yeah, yeah, these are all things we can handle." What if two or three occur at the same time? It doesn't have to be one big one; it can be a couple of little ones. That's another thing that risk management will help you deal with. That's another thing to keep in mind as well, but it doesn't have to be the big one. It can be two or three, four or five, you name it, or it could be two or three that hit the same department, so a lot of good things can come out of this.

We've talked a little bit about reinsurance. One of the things to remember is with risk mitigation you basically replace one risk with another. How many people feel like once you've bought reinsurance you don't have to worry about those catastrophic risks? Good. I think you will find people in the company who say, "Oh, we've reinsured that. We're good to go." If you think about the health reinsurance market, our HMOs in Virginia have to have some level of reinsurance. The Bureau of Insurance has told us that, so we have to do something for them. Lincoln National got out of the reinsurance market. And the health reinsurance market has been shrinking a bit. You can buy reinsurance, but now you may have a credit risk because if a lot of people buy it, you have fewer reinsurers, you could see some go bankrupt if everybody hits at once. It's risk mitigation, not risk erasure, if you will. As you talk to management and as you go through these things keep this in mind.

MR. STEVE CLAY: I don't have a risk for you, but I want to agree with you in that the actuarial area is really well suited to pointing out risk. I have an easy example for you. I also oversee the underwriting department in my company, and the sales guys hate me because I'm a stickler for complete applications. When we bring a group on, every yes/no box has to be checked, even in the employer group application. They say, "You're holding up sales. Why are you doing this?" It's because when there's an incomplete application and you get into a fight over it after the fact, it's very, very messy. You never get into a fight over a case of hay fever, so up front every box checked, everything signed, everything dated and yet other people in the company have trouble seeing the importance of that. It's really a persuasive process to get them to buy into it.

MR. CORCORAN: One way to look at that is whether you can actually set up some metrics on that. The fact that you're enforcing it for every case means there is no control group. To the extent that you can track history of where you've had problems and how big those problems have been, that can lend some technical weight to those arguments.

MR. STARK: I think that gets into an area of risk that's pretty interesting — incentives. What is the sales force incented to do — fill out applications? No, unless you put it in their incentives. They are incented to go out and sell business. Are they incented to sell profitable business? Hopefully, but if their incentive is just based on numbers of bodies and not numbers of dollars to the bottom line, that's what they're going to do. It's human nature that if you give me money to do

something, I'm going to do it. Maybe not exactly like you had in mind, but I'm going to do it. One of the risks you have is whether your incentives line up with your business plan. That was a good example of that. Have any of you seen it on other occasions where that kind of thing happens?

FROM THE FLOOR: You were talking a lot about reinsurers and some of those motivations. I think at least on the health side an awful lot of reinsurers learned that point specifically in that, I would say, the vast majority of managing general underwriters (MGUs) had no profit incentive. If you will, they were acting as brokers with the pen. It's a terribly dangerous situation. I think 90 percent of that has been cleaned up. On the health-plan side of the business, for the life of me, I can't figure out (and this is back to people performance and management) why profitability of business sold is not a significant component of the health-plan sales force.

MR. STARK: Yes, you're right.

MR. CORCORAN: I have an interesting story. I'm not sure how it fits with the topic, but I'll tell it anyway. I have done a lot of work with A&H pools and those were workers' comp carve-out and personal accident. Those were run, as the gentleman from Evergreen Re said, by MGUs who didn't have a piece of the profit. In some cases they had a profit override, but they would manage their risk by retroceding it. So they would take a risk and rather than understanding what the risk was, they would retrocede it onto somebody else and just take their cut. When you hear about the Unicover spiral, that's what it was — the same risk went around and around the same group of brokers and it got smaller and smaller as each one took their cut on each of the passes. When you unwound these, all it was was profit and nobody, in fact, kept any of the claims. It's still unwinding. Everybody thinks they laid the claim off to somebody else and it comes back to them.

MR. STARK: How many have multiple claims systems? Do you think it's a risk? Yes. I know in our company, in some cases, it's just a way of life. We have a couple of people who really do rail against this, really do think it's a risk. Of course, it's not going to change, but it's just the acknowledgment that if you have different claims systems, do they talk to each other? Do they speak any kind of the same language if you're transferring data between the two? Are you cutting off important pieces? That's another operational aspect to think about.

Chart 1

Risk Types
Point of Service

Reden & Anders, Ltd.
An Ingenix Company

The risk is compounded by the tension created when mitigating one risk potentially exacerbates another

Point-of-Service
(Quality of Service)

- Adverse medical outcomes due to negligence (medical malpractice)
- Inflated reimbursements recoveries
- Discrimination in peer review/ratings of doctors

Chart 2

Risk Types
Managed Care

Reden & Anders, Ltd.
An Ingenix Company

The risk is compounded by the tension created when mitigating one risk potentially exacerbates another

Managed Care
(Quantity of Service)

- Harmful cost saving protocols
- Breach of fiduciary responsibility (economic gain)
- Application of inconsistent protocols
- Improper denial of benefits