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Two Chief Financial Officers

Features Editor Deborah Poppel met recently with Bertram Pike and Ralph Verni, Chief Financial Officers of John Hancock and The New England, respectively. They talked about the role of the CFO and the environment in which they operate.

Poppel: As CFO, what are your areas of responsibility?

Pike: This position at the Hancock is less than a year old, so the job is still evolving. Organizationally, we've put together five general functions: the controller, the auditor, the corporate actuary, budgeting, and treasury and financial analysis. This includes setting up and tracking the standards by which we'll measure whether different parts of the company are performing as they should be.

Verni: I was asked to be the first CFO for The New England a couple of years ago, in addition to being the Chief Investment Officer and the person responsible for all of our stand-alone subsidiaries. My responsibilities sound much the same as Bert's — corporate accounting, internal auditing, and the treasury function, including our banking relationships. The key thing that I've been asked to do is raise the level of understanding of the financial dynamics of the insurance company, so we can make more intelligent decisions by knowing precisely where our costs and income come from.

Pike: That's almost exactly the same charge that I've been given. One way to describe it is that this function has been designed to move the company away from thinking of itself only as an insurance company, to instead thinking more like a bunch of businesses, some insurance, some not, each trying to grow and prosper according to normal business standards, as though each was part of a holding company complex. Legally, of course, the insurance company role is quite different.

Verni: Exactly. In our case, mutuality makes us always try to ultimately bring this concept back to the participating policyholders. I consider that an important detail while concentrating on developing measurements that go beyond traditional statutory accounting.

Pike: We're also at the same point of trying to develop a GAAP system, which raises questions of how you're going to use it — internally, externally, or both.

Verni: We're developing a modified GAAP system, similar in many ways to stock GAAP but modified to make more sense for us. Our principal theme is to have the accounting mirror the pricing of our various insurance products.

Poppel: How do you and your staff interact with the lines of business?

Verni: Our function has evolved over the past several years. Where we used to merely gather numbers and add them together to produce combined statements, we now are taking more of a leadership role, and setting some policy and standards; there is now a stronger central control function. We still have very strong financial functions in each of our major business activities, however.

Pike: Again, we're in almost exactly the same situation. We're trying to take what we hope is a highly decentralized, entrepreneurial organization and let the profit centers do their thing, but still maintain a financial control from the top that doesn't let those centers get too far out of sync with the corporate plans.

Verni: Particularly with the needs to allocate capital and to judge results, and as we've rejected statutory as the principal measure of results, modified GAAP has been key to effecting this kind of centralization. Some of our areas had their own versions of GAAP accounting which were not always consistent.

Poppel: With all these financial people, who makes the decisions?

Verni: I'd like to think it's a highly participative process. Certainly the people in each entity have a lot more specific knowledge about their businesses and their products, but I think there's a much stronger corporate control in ultimate decision making. Some of these issues go as far as the executive committee, so all of top management gets involved in the process of going from the accounting and financial management approach of the 1960s and 1970s to the one of the 1980s and 1990s.

Pike: You almost have to assume that any system like this is going to have a certain amount of tension. Nobody can set down a rule saying, "The operating unit won this vote, so corporate will win the next." It's an interactive process, and one would hope that in that dialogue the two parties would end up agreeing and that the best possible decisions will be made.

The generic answer is that corporate sets the policies, and the business units are responsible for making them work. The line between those is not as clear as it sounds. We're going to have issues, as The New England does, where I disagree with the head of a business. We'll both try as hard as we can to agree, but if we don't, it will end up in the hands of the Chairman and President. When you have, for example, $150 million in capital to distribute, and the business units' very legitimate needs add up to $500 million, it is entirely appropriate that the decision making should happen at the top.

Poppel: Is it just a coincidence that two major companies independently moved to a similar structure in the past few years, or was it caused by changes in the financial environment?

Pike: Issues such as the run up in interest rates and the need for asset-liability matching focused attention on things we never really had to worry about. This has come at the same time that many insurance companies have moved into diversified kinds of businesses. We now face a set of problems different than those in the past, much like the problems faced by any diversified commercial enterprise. We used to be able to count on a steady flow of premiums coming in and cash going out, as people died and surrendered policies; we now have more outside pressures that cause our income and outgo to fluctuate. We now have a cash management responsibility that we never had before, and insurance companies having to raise capital is a relatively new phenomenon. Basically, it turns out we're not just insurance companies any more, and we have to stop thinking of ourselves that way.

Verni: I agree. In addition, the competition we face when trying to keep our entities growing and healthy is such that you can't just depend on the same products and who you sold them to and how you sold them. As we've added products and services, we've come into a new competitive world that requires us to understand

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Two CFOs Cont'd.

the financial dynamics of the products — the pricing, the profitabilities, the capital needs, and so on — much more than our predecessors had to understand. We need to make much more explicit decisions, and we're going to live with their consequences a lot longer. In the past, there was a longer time frame between and when you did something and when the real impact of it showed up.

Pike: That's if you ever knew about the real impact!

Verni: True. It often just blended into the amorphous mass called statutory accounting.

Poppel: *What do you expect from the actuarial function in your company?*

Verni: We depend very much on the actuaries, for our insurance products, to continue to practice their craft skillfully, with a note of conservatism but maybe not quite as conservative as in the past. My biggest theme is to ask the pricing actuaries and financial actuaries to help us effect in our measures the stochastic reality of our world. They've always dealt with stochastic aspects when they dealt with mortality; they should do the same for the expenses, the cash flows, and so on. We need to do more of the "what if?" kinds of analyses to really understand the possible outcomes so we can allocate capital more effectively.

The actuaries should also help us "non-card carrying" actuaries to learn a little bit more. We've got to get rid of the actuarial mystique that we tease about. We shouldn't be teasing about it in five or so years.

Pike: In our new organization, we've taken a lot of the technical planning functions that were dispersed throughout the company and put them all in one place. At the corporate level, we now expect the actuary to be one person on a team of several people, all with different technical skills. He or she brings the actuarial viewpoint to the process, but doesn't control the whole process. Actuaries need to be able to communicate with and educate the rest of the team so that together they can make the best decisions.

Poppel: *How does the emerging valuation actuary role fit in with your job?*

Pike: To me, the term *valuation actuary* is still ill-defined — the concept seems to be farther along in Canada and maybe elsewhere. Our corporate actuary has, as one of his responsibilities, the job of certifying reserves for the whole company.

Verni: I agree that the concept is evolving. We're trying to go beyond a straight C-1, C-2, and C-3 risk analysis approach (which is still important) to an approach which looks at the assumptions made when pricing specific products versus the actual experience. We're still in the learning stages, but we hope to end up with an approach which is more pragmatic and less static than the traditional valuation methods.

Poppel: *What advice do you have for those who aspire to be CFOs?*

Pike: I have to answer that based on how I believe the job will evolve. The single most obvious thing I would say is to develop a business orientation, either through an MBA or management experience in different parts of the organization not necessarily actuarial. I don't think that the old concept of how an actuary is trained fits very well with the CFO role — that training doesn't get into the interpersonal experience and business dealings that you need to make the job work.

Verni: I think anyone in an insurance company who aspires to this job should be looking for opportunities to diversify his or her career. The ideal person could be an actuary or an accountant, but not necessarily — he or she needs some of those skills, but can develop them by working in a related area. It would be great to spend some time in the investment function or even outside the industry.

Poppel: *What is the biggest challenge facing you in the next year?*

Verni: There seem to be so many! If I had to choose one, it would be conceptually agreeing upon and implementing a methodology for allocation of equity-type capital and defining return measures so that we have a return on equity kind of approach that applies to all of our lines business.

Pike: We're at the same spot. We think we know what those definitions ought to be — now we're trying to reach agreement with the operating areas that the measures are reasonable. The big challenge is making the concept operational.

In Memoriam

Fernand Pare F.S.A. 1959
John G. Selig F.S.A. 1959
Huntly G. Walker A.S.A. 1955
Harold G. Walton A.S.A. 1925

Competition Results

by Charles G. Groeschell
Competition Editor

We have three new co-champions with perfect records for the eleven Actucrossword puzzles in the last fiscal year ending with the June 1987 issue. They are D. C. Baillie, Robert C. Martin and Jonathan Schwartz. D. C. Baillie has shown steady improvement ever since your CE did not catch the misspelling of his name several years ago. Bob Martin, on his January solution, commented, "I was not 100% in November, having missed the word *forearm*." He had *firearm* instead of the official *forearm* as did almost half of the other solvers that month. After consulting expert solvers of our Actucrosswords, we decided to accept either one as correct, but Bob was the only one who tried not to take credit for our unusual show of generosity. As for Jon Schwartz, he is lucky to be recognized as a champion because he missed the April solution. Then your CE noticed an anonymous correct solution that month, and after a handwriting analysis, recognized it as Jon's. (Jon is one of a few solvers who doesn't make sure his name is on his solutions. Your CE usually notices this when opening the mail. If the solver's name is on the envelope, he makes the solution "non-anonymous." In this case he missed, but wishes all solvers would identify their solutions so he wouldn't have to do it in the first place.)

The number of solvers continues to increase. A total of 535 solutions were received and 4 out of 5 were 100%. However, the monthly variation was extreme. In February, 31 solutions were received but only 11 were 100%, while in May we had 67 solutions out of 72 that were 100%. Usually, the solutions that are not 100% will miss on the same tough clue. However, in April when 21 solvers out of 59 failed to achieve 100%, seven words were missed by one or more solvers.

We had six runner-ups with 10-1 records: William A. Allison, John W. Grantier, Robert D. Hohertz, Gary D. McDonald, Robert A. Miller III, and Esther Portnoy. Those with 9-2 records were Andrew P. Johnson, G&D Mazaitis and Beth (Mrs. John S.) Thompson.

Each co-champions may nominate a candidate to receive a free subscription to *The Actuary* until June 1989. Do this by notifying Susan Pasini at the Society office in Itasca.