

**DIRECTING ACTUARIES IN A
LOCALIZED ENVIRONMENT**

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Biography:

Mr. Shrum is the Chief Actuary for the Hanover Insurance Company in Worcester, Massachusetts. Prior to joining the Hanover, he was the Chief Actuary at Pennsylvania National and held various actuarial positions at Liberty Mutual. Mr. Shrum began his career as an underwriter for Liberty Mutual in Philadelphia. He received a B.S. degree in Mathematics from the Pennsylvania State University in 1972. He became a Member of the American Academy of Actuaries in 1979 and a Fellow of the Casualty Actuarial Society in 1980.

Abstract:

Management has not been a prevalent theme in actuarial literature. Technical issues predominate, as they likely should in such a technically-oriented organization. However, many of us work as managers of actuaries. Several of us are in positions that require us to direct actuaries who are located in remote offices.

The purpose of this paper is to outline key considerations in the management of actuarial resources in general, and **remote** actuarial resources in particular. Compared to the relatively easy task of monitoring the quality of the work product of individuals who work in the same building as you, remote actuaries present a different set of issues -- and a much greater challenge.

BACKGROUND

The most significant challenge to an actuarial manager is to create an environment which helps each person to achieve his or her full potential. A value-oriented, vision-driven organization can facilitate the creation of such an environment.

Think about an environment where decisions are based on merit, where people are expected to express their opinions openly, and where decisions are made as close to the point of contact with the customer as possible. Within that operating framework, any technical, professional work group can be expected to flourish to the extent that the individual professionals take ownership for what they can do.

A few words of background will help put the following ideas in proper perspective. The underlying organization has highly autonomous local operating units. These units are geographically distinct from the headquarters of the organization. Each seeks out opportunities unencumbered by heavy oversight from headquarters. Each of these remote offices has resident actuarial resources.

THE ENVIRONMENT

Let's consider the concept of Localness, a term not limited to geographical constraints. In many large organizations, there are a multitude of reporting levels within each functional department. Decisions are reached only after a series of discussions by people who may know little about the issue at hand but whose position requires that they know about and have their hand in the decision. After all, if it's an important decision, the people at the top of the hierarchy must be involved. What does that kind of structure mean to those who may be closer to the customer, those who need to sit across the table from the decision-maker or impacted parties (agents, policyholders, legislators, etc.) and explain the "official position". How long would those individuals want to remain in that role? How long would it be before they feel that the vertical career path is the only one worth pursuing? The "top of the hierarchy" is the goal, regardless of the sacrifices in customer relations that are encountered along the way.

In an organization which does not have an emphasis on a vertical career path, where does that leave the actuary? The opportunity for the application of actuarial skills is tremendous in such an environment. Let's think about merit-based decisions. Every organization needs decisions that are merit-based, reflecting the best possible solution at the time, regardless of who makes the

recommendation. This means that both the intuitive and the analytical aspects of decision making need to be addressed. Delivering strong **subjective** skills to the decision-making table has never been a problem for most insurance companies. Actuaries are objectively oriented people, typically reductionistic by nature. This relatively narrow focus starts to broaden somewhat after actuaries develop some experience. They start to realize that good, sustainable decisions require that both sides of the process are touched upon. However, the analytical foundation remains and can add considerably to the decisioning process. Bottom-line, if merit-based decisions are required by the environment and such decisions need both analytical and intuitive attention, who else but the actuary is better equipped to deal with the more objective aspects of the issue at hand?

Openness requires that people are active participants in the decisions. All parties to the decision use their own personal initiative, share ideas and insights, and take responsibility for their own actions. Clearly, highly flexible organizations willing and able to respond to an ever-changing marketplace need the capability to make decisions somewhat quickly. Strategically deploying actuarial resources close to the decision-making facilitates the actuarial perspective being more readily available.

ROLE FOR THE LOCAL ACTUARY

Localness requires that functions which can be more effectively accomplished closer to the decision-making, should be. Take for example the responsibility for making rate recommendations for a limited volume state/line. Many companies may have fairly inexperienced actuaries crunching numbers to develop such a rate indication. More experienced and possibly credentialed supervisors get involved to review the work product. That review should not be a perfunctory test of actuarial judgments. If it is, the vertical career goal is again reinforced to the inexperienced actuary. The supervisor's review should provide a broader perspective. That review should address the analyses in terms of overall revenue needs and highlight sensitivities of key underlying assumptions. It should explain the effects of long-term marketing strategies, shifting underwriting quality, and changes in claim-handling philosophy. If such a review does not take place, the inexperienced actuary fails to learn about the pricing "delivery system". Hence, the horizontal growth that would make the analysis more meaningful is stunted.

In an organization that stresses individual accountability, the right type of actuaries are expected to assimilate the variety of inputs from persons in other disciplines (underwriting, marketing, claims) as well as more experienced actuaries. Such actuaries communicate well, work well independently, and recognize

when they need to ask for help to assure that the decision-maker is presented with the best possible analysis. Such actuaries need not be an FCAS, but should recognize how their analytical foundation could be enhanced through professional accreditation.

Remote actuaries perform their analyses within the framework of operating plans that are prepared once a year and revisited periodically during the year, as assumptions play out. These Proformas provide the focus of the local actuarial work. The development process enables the local actuaries to identify important educational needs of the other members of the management team of the local operating unit. Those actuaries can facilitate deeper understanding of more technical issues such as the relationship between policyholder retention and profitability, the impact of changes in case reserving philosophy on local results, and the varying patterns of emerging IBNR by line. While such plans are typically oriented toward "forecasting results", the emphasis in the described environment is on thoroughly testing the assumptions and on enhancing the understanding on the part of the decision-makers of key financial drivers that impact results. A better educated local management team makes better day-to-day decisions.

Local actuaries have a distinct advantage in being able to interpret the data from the local perspective, sometimes drawing upon causes that are not typically addressed in an actuary's work.

This leads to valuable involvements outside of the pricing realm. Examples include the incorporation of the concerns and observations of the agents into various analyses, enhancing regulatory relationships, evaluating local financial reserves, interpreting balance sheets for the local decision-makers, assisting with the development of new products, and ensuring the capture of quality data for profitability analysis.

LOCAL ACTUARY'S CAREER PATH

So, what about the career path? Horizontal growth is encouraged. Developing a stronger sense of what is going on in the profit center and playing a greater role in its' success requires that the actuaries grow in their breadth of understanding. They remember at all times that a primary purpose of the insurance company is to provide quality insurance protection to as many people as resources permit. Those people have many options. They will insure with the company who takes the time to truly understand the customers' needs. Firmly believing that and being proactive in learning the role that the actuary can play will enable those actuaries to grow optimally. In the process, the local actuaries become more highly focused on the identification of the right customers and then addressing those customers' needs appropriately.

THE ROLE OF THE HOME OFFICE ACTUARY

What role does that leave for Home Office Actuarial within a decentralized operating environment? The role for the "core" actuary can be described in terms of six fundamental functions.

First of all, actuaries in the core are responsible for raising the level of thinking about specific products that are sold so that they can function at the leading edge of new developments and respond to the emerging and ever-changing needs of the customers. This requires that the actuaries maintain close working relationships with many experts both within and outside the company. They need to review and interpret a great variety of published information affecting such products.

Secondly, the core actuaries need to develop and maintain recommended ratemaking and reserving systems. Current knowledge of alternate ratemaking and reserving procedures used in the industry would be required to guarantee that the procedures are efficiently delivering meaningful and responsive analyses.

The core actuarial department needs to quantify overall corporate rate and reserve needs, regardless of the extent of

such activity performed in the local profit centers. The overall revenue need analysis provides a framework for evaluating the soundness of the individual reviews. These efforts should also result in a deeper understanding of key assumptions that would be incorporated in the work product of the local actuaries.

The fourth fundamental core responsibility is the training necessary to allow those local actuaries to do high quality analyses within their local operating units. The technical abilities of those actuaries will likely vary considerably, as well as the background and the recognition of knowledge gaps. These need to be addressed to make sure that the locally developed work is sound.

For those profit centers that have encountered temporary openings in their actuarial staffing, the core group would provide substitute actuarial services.

The last major area of involvement is the support role of the core group to test the locally developed work through regularly scheduled reviews and second opinions offered on that work. These reviews are critical to ensuring adequate peer review of the locally developed work. They will be covered in some detail in the next section.

The development of the local actuaries is critical to an organization that is strategically oriented around local profit centers. Clearly, the hiring of those local resources is done very carefully, including long and thought-provoking interviews with people from various backgrounds, testing for intellectual capacity as well emotional maturity. The initial fit is very important because the working environment is different -- the steps are there, but the handrails are missing.

The local actuaries realize the important role that they play and are focused on delivering the best possible analyses to the profit centers' decision-makers, regardless of whose comments and opinions are incorporated. Second opinions are readily available from the line specialists in the Home Office Actuarial Department. Those second opinions are sought out, not because that is required, but because the local actuary wants to develop and has a complete commitment to seeking out the best possible understanding of the issue at hand.

LOCAL ACTUARIAL REVIEWS

Standard actuarial review criteria include the following:

- a) Communication Skills: written, spoken, and listening skills. Also reflected here is the ability to adapt a review of technical material to the audience.

b) **Fundamental Job Skills:** problem-solving abilities, assimilation of new information into analyses, judgment, and decisiveness.

c) **Work Ethic:** job motivation, work standards, integrity, deadline orientation, and commitment to lifetime learning.

d) **Maintaining Effectiveness:** behavioral flexibility, tenacity, and tolerance for examination and organizational stress.

The management of actuaries located in remote locations takes on a different slant. The reviews of such resources do as well.

The reporting relationship for the remote actuaries would be to the Director of Home Office Actuarial for technical development and for coordination of the local work with efforts in the Home office. Those local actuaries would report to the local profit center manager for administrative purposes.

Unchallenged thinking can cause skills to atrophy. The testing of the actuaries' technical skills allows them to develop. In the case of remote actuaries working in an office with limited peer review possibilities, the challenge to maintain the crispness of the function is a formidable one. However, it is not

insurmountable, especially if the communication lines are wide open and the focus is always on delivering the highest quality work product to the decision-makers as possible.

A possible approach follows:

1) The work product of the remote actuary for the review period would be forwarded to the Home Office review team for analysis and comment. That review period should be of an agreed upon length of time. The material subject to the review should be a representative sample of the work. Specific analyses could be requested by the Home Office reviewers. Several actuaries at the Home Office with product line expertise would review for:

a) completeness -- Did the actuary seek out the appropriate people to test assumptions and to get input on methodologies? Were all of the statistical constraints attended to?

b) quality of the thought process leading up to the recommendation -- Was the work consistent with the concept of the "actuary as forecaster"?

c) creativity in approach (when called for) -- Are there new ways to more effectively develop the analysis?

d) communications -- What efforts were made to explain the recommendations to the decision-makers? What efforts were made to explain the decisions to the regulators? How well was the analysis documented?

2) During the review period, the reviewers should receive information on the remote actuary's work plan, through weekly or monthly project lists or whatever the remote office uses to monitor work volume. While much of the commentary on priorities and work volume would have to be heavily qualified, the review team would likely be in a position to comment on the potential payback on the work being performed. The review team always needs to be mindful that the cost of the local actuarial resource is entirely borne by the local profit center budget.

3) The review of the material could be performed anywhere. The discussion and feedback should be conducted in the remote office. The presence of a local actuary from another office could provide much needed perspective for the review.

4) As part of the on-site discussions, the reviewers would interview others in the remote office to gauge the effectiveness of the remote actuary's communication skills and the added value from having resident analytical resources.

OTHER MEANS OF ASSURING QUALITY WORK

The success of remote actuaries relies heavily upon putting the right people in place. Such actuaries can function equally well in a more independent role, are not defensive about peer review, and are extremely good communicators. However, good hiring practices and quality reviews are not enough to assure appropriate meshing of core and remote resources.

The importance of the strong foundation provided with published procedures for analyses cannot be over-emphasized. This documentation should be kept current, reflecting the latest thinking of the Home Office experts and the latest available data.

Periodic gathering of all actuarial personnel helps to solidify working relationships and keep the communications wide open. These regular meetings can provide a forum for testing ideas. Other forums include CAS seminars, regional actuarial meetings, and rating bureau committees.

CONCLUSION

As professional actuaries, we are constantly striving to hone our analytical skills, as we should. However, developing the best possible conclusions from a careful review of the data can be

incomplete. The need to effectively convey observations and recommendations to the company's decision-makers is of paramount importance. Close working relationships between a company's profit centers and its actuarial resources can facilitate the successful incorporation of actuarial work product into company operations.

This paper outlines some considerations involved in directing actuarial resources when a company's profit centers are not within the confines of the Home Office. The challenges are significant but not impossible. High levels of accountability reside with the remote actuaries. Careful hiring and direction can assure that these actuaries grow and develop to their full potential. The positive impact on the organization's results will naturally follow suit.

