

## THE COMPANY ACTUARY AND THE BUREAU ACTUARY

STEVEN H. NEWMAN

Many among those here today are employed by insurance subsidiaries of essentially non-insurance holding companies; many represent subsidiaries of holding companies whose main business is, or has been, insurance; and many represent companies which are about to either succumb to, or reorganize their corporate structure into, one of these two situations.

You may ask, what do these corporate-financial configurations have to do with the subject of this discussion — open competition rating laws and the actuary? The answer is simply that although both subjects involve a great many diverse considerations, the element common to both is profit. Virtually every other business in America lives by the system of competitive private enterprise. Each figures prices on the basis of its estimated costs and then takes the profit or loss, usually without public or governmental interference. Capital can be kept at work in an insurance enterprise only when the risk-return expectation compares favorably with other opportunities. The holding company provides a convenient vehicle through which stockholders can withdraw capital funds from insurance operations and reallocate them more profitably. In 1969 almost \$1 billion of such upstream dividends were recorded.

It appears to me, as a not too impartial observer, that open competition rating laws offer insurance managements their last chance to maintain and increase their share of investment capital, and therefore their capacity to underwrite insurance.

So what has all this got to do with the company casualty actuary? Who else but the actuary will be responsible for setting rates at profitable yet competitive levels? Who else is as well qualified by education, training and experience to pinpoint pockets of profit and to price new coverages and packages? And when the crutch of the cumbersome and often unresponsive prior approval regulatory system is removed and open competition laws take effect, upon whom will the ultimate burden fall of explaining to your President why underwriting losses occurred in some sufficiently credible classes of business?

And assuming that we will be able to satisfactorily fulfill these charges, who will then be called upon to maximize corporate earnings from insurance

operations? How much business can your company put on its books safely without over-straining surplus and subjecting it to severe depletion. What is a company's capacity? Is it related to its ability to charge a sound rate? Of course! Is it related to the type of coverage sold, the average policy term, the rate of premium collection? How about average size of loss, probable maximum loss, maximum foreseeable loss, claim frequency, and the degree of variance by insured risk for each of these?

In my opinion the company actuary will be called upon in the well-managed company to answer these questions, to simulate the many possible results in connection with the company's corporate model (to which he will substantially assist in developing), and to select the most satisfactory course of action and project his company's profit and growth into the future so that realistic goals can be set up. The implications of such endeavors are enormous, and involve every phase of a company's operations from ratemaking to data processing, underwriting to claims adjusting, personnel requirements to investment of securities.

What does all this mean for the company actuary? At the very least he is saddled with a great deal more responsibility than ever before. In most companies a realignment of responsibility among its various departments will take place (if it has not yet already been accomplished). We can look for a reallocation of manpower, financial resources and internal priorities, all of which will favor the actuarial, data processing and statistical operations. The actuary inevitably will become involved in the mainstream of company operations to a far greater extent than in the past. The stress will shift in the systems and statistical areas from primary emphasis on "statutory reports" and "bottom-line management reports" to actuarial analysis requirements. Information will rival salesmanship and underwriting as the dominant factor in building a growing and profitable insurance portfolio.

The increase in the scope of the actuary's functions and the greater the responsibility he will bear for insurance profits, the larger his staff must become and the more departmentalized and specialized. How else will it be possible to adequately handle responsibilities in ratemaking, research and development, systems and data processing, reinsurance requirements and negotiations, corporate planning and model building, reserve analysis, and management information systems?

And what about the ratemaking and statistical organization actuary? What becomes of his functions under rate laws such as the one currently in

effect in New York under which the primary responsibility for establishing and supporting rate levels is transferred to the company actuary? In my opinion the ratemaking roles as they were practiced among actuaries of rating organizations and their member companies will become transposed. Whereas committees of company actuaries actively participated in the development of theoretically proper ratemaking formulas and the necessary refinements, and the bureau staffs guided the adoption of rates to be finally followed on the basis of practical considerations, under open competition laws the roles will be reversed. This outcome reflects the impact of passages such as this one from the present New York insurance statute, section 177 item d, dealing with the prohibition of anti-competitive behavior:

“No insurer or rating organization shall make any agreement with any other insurer, rating organization or other person the effect of which may be substantially to lessen competition in any territory or in any kind, subdivision or class of insurance.”

Our lawyers tell us that, in New York, ratemaking in concert via the bureau actuarial committees may be construed as an act that lessens competition through joint establishment of a rate or series of rates. Thus company actuaries will have to set their own rates after independently considering the facts. However, we all recognize the need for establishing a broad data base from which to analyze experience, especially when territory and classification refinement is extensive; and if New York-type rating laws became universal, the company actuary would need, more than ever before, the classified data with theoretically pure adjustments and supplementary projections in order to be in the best possible position to determine his own company's course of action. In my opinion then (and of course, without specifying the many notable exceptions both as to type of regulatory law and rating or statistical organization) whereas in the past the company actuary needed to emphasize the theoretical truths and the bureau actuary the pragmatic considerations, under open competition laws the bureau actuary becomes more the researcher, the technician with unbounded objectivity and more service-oriented in his dealings with affiliated companies, while the company actuary is confronted with the practical considerations of what to charge and how to increase profits without permitting any leakage of profitable business to the competition.

In summary, the advent of open competition rating laws will present challenges in the insurance marketplace that will undoubtedly enhance the

value of actuaries to their companies, and at the same time dramatically increase the need for the actuarial services rendered by statistical and advisory ratemaking organizations.

THE CONSULTANT  
LEWIS H. ROBERTS

The pricing of insurance is important at several economic levels. At the most parochial level, from the insurance company's point of view, its rates determine the amount and kind of business that it will attract and the profitability of that business. The interest of an actuary in the price of insurance often begins and ends at this level.

From the standpoint of the industry as a whole, the price of insurance determines its profitability and the extent to which it is used as a means of meeting risk, as opposed to other alternatives such as the self-assumption of risk or its elimination through cessation or change in mode of operation. According to economic theory, competition should redound to the benefit of the general public by forcing the price of each coverage to the lowest level consistent with an acceptable profit to the insurer. The aggregate of individual decisions on the amount and kind of insurance purchased at the offered price then determines the extent to which society utilizes insurance as a means of meeting risk. It is in this way that a competitive economic system determines the allocation of economic resources generally.

At the level of the individual company and at the level of the industry as a whole, the price of insurance performs the same economic function as the price of the product of any other business. The insurance industry, however, has a special function in the general economy which transcends the selling of its own product. It determines and assesses from policyholders one of the major costs of carrying on almost every enterprise — the costs of a wide variety of unpredictable contingencies. Inclusion of the insurance cost in the price of a commodity then forces buyers to consider whether they want the product enough to bear the cost of accidental damage and injury to persons that accompanies its production, sale and use. Thus, the insurance industry plays an extremely important role in guiding society to an economically efficient allocation of resources in all industries, not merely its own.

When the government regulates insurance prices, it becomes the arbiter