PRICING FOR CORPORATE OBJECTIVES

by Frank Karlinski

Review by Robert A. Anker

My initial impression of Mr. Karlinski's paper was that it is a sales piece aimed toward fuller utilization of the actuary's training and skills in the pricing decision process. Subsequent readings confirm that impression.

The premises of the argument Mr. Karlinski espouses go like this:

1. Often the ratemaking/rate review process performed by the actuary is a pro forma data analysis function. (Mr. Karlinski later refers to this as "no goals" ratemaking.)

2. The nature of the insurance pricing/underwriting/marketing process is such that each of these components are interdependent with each other and with profitability.

3. The quality of decisions made is directly related to the quantity and quality of information available at the decision point.

Mr. Karlinski first argues that, where the first premise applies, it represents underutilization of the actuary's skills and that, at a minimum, the relevant interdependence inherent in "no goals" ratemaking should be valued and fed into the decision process. This would represent, as a first step, an enhanced utilization of the actuary's skills, some recognition of interdependence, and some improvement in the information available at the decision point.

Without an explicit identification, Mr. Karlinski then points out that the corporate goals tend to be marketing and profitability oriented and set independently of pricing/underwriting considerations and, often, independently of each other. To provide the link among all variables, he identifies the need for pricing policy. In discussing the pricing policy, he often refers to it as a pricing strategy. The term strategy is highly preferred, both because it is more descriptive and because it is the more commonly used term in the literature on corporate planning which is, to a large extent, what this paper is about.

Once the strategy link is included, complete with all its necessary feedback loops, the pricing/underwriting/marketing/profitability interdependencies have been recognized and can be valued. The valuation provides the vehicle for maximizing the quality and quantity of information to the decision maker. The actuary becomes key to the process because he is most qualified to accomplish and interpret the valuations to the decision maker(s).

Thus, to the extent that each of the premises indicated a deficiency in existing processes or an opportunity for improvement, corrective mechanisms have been identified.

There are companies who have achieved the processes for which Mr.

Karlinski argues, and some that have gone beyond them. Where the full loop exists, the actuary is intimately involved in the goal setting process itself. It is the actuary who provides the analytic guidance on all past and prospective goal interdependencies within the context of the corporate mission and long range plans and strategies.

I agree with Mr. Karlinski's premises and his conclusions. However, there are a few deficiencies or unrecognized opportunities that might be noted:

1. Coverage and underwriting standards are as equally a part of the interdependent structure as rate and market position. They also need to be recognized in the process and, by that recognition, can afford additional flexibility to the process.

2. There are also opportunities to affect the balance of the various items through changes in the expense portion of premium dollar.

3. The same arguments for strategizing from corporate goals to a state-by-state level are valid for strategizing the ratemaking within a state. Indeed, this is probably the key place for an actuary to start demonstrating the skills that can apply at a higher level.

4. In attacking the problem of sacrificing some profitability in a given state in order to gain market position, it is more

proper to use surplus funds for that expansion and require that the necessary return be gained over time from the specific state. This is both a better business basis for decision making and an approach less open to possible regulatory criticism.

Finally, speaking as both an actuary and a corporate planner, I feel that the questions Mr. Karlinski articulates as needing to be addressed by the actuary are "right on." But, even more importantly, they are questions that must be asked by management in order to realize optimum use of corporate resources.