TURNING A BUREAU INTO A BUSINESS

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BY

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BIOGRAPHIES:

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Michael Fusco is Executive Vice President and Chief Operating Officer of Insurance Services Office, Inc. Mr. Fusco began his actuarial career in 1970 with the Insurance Rating Board, an ISO precursor. He has held many actuarial and executive positions with ISO and served as its Chief Actuary from 1983 to 1987. Mr. Fusco was a principal with Ernst and Whinney in 1988, when he returned to ISO. He received a B.S. in Mathematics from the City College of New York in 1971 and a J.D. from Fordham University Law School in 1978. He became a Fellow of the CAS in 1976 and is a Member of the American Academy of Actuaries. He has served on several CAS Committees, the CAS Board, and the Executive Council. He was the CAS President in 1990.

ABSTRACT:

ISO, Insurance Services Office, has often been called an actuarial organization because that has always been one of its fundamental strengths. No other entity in the property casualty insurance industry hires as many actuarial trainees each year. Counting students and CAS members, the size of the actuarial department has approximated 200 in recent years. The number of CAS members employed by ISO has been a consistent 35 to 40, although the individuals have changed through the years. The number of current Fellows of the CAS who have worked for ISO (or the organizations that pre-dated ISO) at one time in their careers exceeds 100, and the number of such Associates exceeds 50. ISO indeed has served as a training ground for many actuaries in the property casualty industry.

This paper will describe a reorganization of ISO that took place in 1992. A significant factor of the reorganization affecting actuaries involved the splitting of a single, unified ISO Actuarial Department into various product units. ISO still has a large number of actuaries; and, in fact, one third of its officers are members of the CAS. This paper will concentrate on how ISO's actuarial personnel are adapting to the revised organizational structure, the latest in a series of steps that are turning a ratemaking bureau into a customer-driven service organization.

I. INTRODUCTION

Insurance Services Office (ISO) was formed in 1971, taking on the activities of several prior industry associations. Throughout the 1970s and 1980s, ISO took several evolutionary steps changing itself from a rate bureau (the successor of the rate cartels of a half-century ago) into a service organization. This paper describes the more revolutionary steps taken in the 1990s to transform the organization into a customer-driven business.

ISO has often been called an actuarial organization because that has always been one of its fundamental strengths. ISO provides loss cost, statistical, policy form, and other related services for 15 property/casualty insurance lines. No other entity in the property/casualty insurance industry hires as many actuarial trainees each year (averaging 39 for the past 12 years, with a peak of 59 in a single year). Counting students and CAS members, the size of the actuarial department has approximated 200 for several years. The number of CAS members employed by ISO has been a consistent 35 to 40, although the individuals have changed through the years. In fact, the number of current Fellows of the CAS who have worked at one time in their careers for ISO or its precursors exceeds 100 and the number of such Associates exceeds 50. Moreover, 12 past CAS presidents can be counted among ISO alumni and staff. ISO indeed has served as a training ground for many actuaries in the property/casualty insurance industry.

This paper will describe a reorganization of ISO that took place in 1992. A significant factor of the reorganization affecting actuaries was that the single, unified ISO Actuarial Department was split into various product units. ISO still has a large number of actuaries; and, in fact, one third of its officers are members of the CAS. This paper will concentrate on how those actuarial personnel are adapting to the revised organizational structure.

II. PERSPECTIVE

From its formative years, ISO had its principal strength in the actuarial discipline. To promote that and other strengths, the organization was structured along functional lines -- actuaries worked for actuaries; line of insurance staff (e.g., policy form drafters) worked for line of insurance seniors; and the same held for programming staff, government relations staff, and marketing staff. There were plenty of products (categorized as rates, rules, forms, data) but few, if any, "product owners." Various professional disciplines contributed specialized expertise (with actuaries providing a significant contribution), and the products were built and delivered.

There was a need to market the products -- but to regulators, not to insurer customers. There were not individual customers, but rather one big customer -- the industry. ISO insurer committees made all decisions on the products; and products developed in that manner were -- by necessity -- consensus ones, designed to be of use to the greatest number of insurers.

All that has changed over the past few years. In March 1988, several state attorneys general brought a major federal antitrust suit, attacking certain policy form drafting activities of several insurers, reinsurers, and ISO. As of this writing, the suit is still unresolved (although a separate Texas suit on the same subject was settled). The McCarran-Ferguson Act, which grants a limited antitrust exemption for the property/casualty insurance industry, has been under steady pressure for the past 20 years; but the 47-year old law also remains unchanged. McCarran has special import for ISO because of its unique structure as an organization whose participants are competing insurers.

In 1989, the ISO Board of Directors chose to take action voluntarily to extricate ISO from this environment and to move the organization in new, more independent directions: committees would relinquish certain authorities to an independent and professional staff; public directors would become part of the ISO Board; and, most importantly, the organization would cease developing advisory rates. Instead, ISO would distribute advisory prospective loss costs.

These actions signaled a change in culture. Insurers would have to do more on their own -- evaluate ISO loss costs to determine ifappropriate for them, ascertain their own prospective expense and profit needs, make and defend their own rate filings with regulators, and decide how to get the approved rates to their manualholders.

ISO recognized that many insurers would need help and that it would have to think of them as individual customers -- some would need certain special services, while others would need different ones to adapt to the new environment. A transition from developing products designed for the common good to designing products more tailored to the needs of individual insurers would have to be made.

The loss cost announcement was made in April of 1989, with a specific implementation schedule established. The conversion for certain major lines would be initiated in 1990, but all ISO lines in all states were targeted to be on a loss cost basis by the end of 1993. As of this writing, all but two jurisdictions (New Jersey and Puerto Rico) have adopted workable loss costs procedures; and other organizations (e.g., NCCI, Surety Association) have embarked upon the same mission.

To find out what customers needed in the new environment, ISO staff formed focus groups of interested customers. Three insurer groups were formed, representing large, medium-sized or regional, and small insurers to ascertain their diverse needs; a producer group helped identify how the agency force would be impacted; and the NAIC appointed a regulatory task force to make sure the whole system worked. ISO also conducted team visits to individual insurers, with ISO actuaries playing a significant role in these visits. The understanding gained led to ISO developing information bulletins (circulars) providing "soup-to-nuts" details on what constitutes a loss cost reference document. Insurers bear the responsibility for converting advisory prospective loss costs into their own rates.

Through this process, ISO became more interested in the individual needs of insurer customers. ISO staff no longer had to respond exclusively to committee requirements but now had to be concerned with individual customer satisfaction as well. A cultural change was taking place, and a reorganization had to follow.

III. ISO'S NEW STRUCTURE

ISO's loss cost-transition research identified requirements that individual insurers (or groups of insurers) expected would be needed in the loss cost environment.

For example, some insurers wanted aid in generating rates from loss costs. Others required historical expense information. ISO actuaries and systems experts developed products to respond to those requirements.

ISO actuaries were also ready to develop additional products to aid insurers in performing activities that ISO had handled in the advisory rate environment. Specifically, ISO actuaries were prepared to develop rate of return or investment income software for insurer use in those jurisdictions that require reflection of investment income in the ratemaking process. But customer research determined a lack of insurer interest in such products, and staff was able to redeploy those resources that would have been involved.

This last example marked the beginning of true cultural change at ISO. Until then, insurers had not charged ISO staff with determining what individual insurer customers wanted. But now, ISO staff had to begin to learn how to ask about what those insurers require -- no longer assuming that ISO knew what was needed. This process involves listening to what customers are saying and building responsive products and services that work in insurer customers' environments.

The ISO Board of Directors' decision to change many aspects of ISO's corporate governance was key in transforming a bureau into a business. As opposed to ISO staff making recommendations, staff now makes decisions.

ISO actuaries determine trend, loss development, increased limits and other methodologies. The actuary's responsibility no longer involves convincing insurer committee members of what should be done. Rather, the ISO actuary must gather information, form insurer customers into focus groups, and bring the resultant actuarial work product back to committees of insurer actuaries who now act as peer review groups. But decisions on methodology rest with the ISO actuary.

From an actuarial perspective, the experiences gained during the transition from advisory rates to advisory prospective loss costs taught some valuable lessons in dealing with customers:

- Providing a service in the same manner as last year was not only <u>not</u> the best objective, it might not be enough to satisfy individual insurer customers.

- Dealing directly with insurer customers and trying to improve their satisfaction with ISO products and services would not require compromising actuarial integrity.

- Listening and responding to insurer requirements can lead to more effective product development, which can translate readily into customer satisfaction.

Taken together, these customer perspectives present a challenge and an opportunity to the ISO actuary. The challenge involves translating years of experience in dealing with one kind of customer -- regulators -- into effective service to the insurers on whose behalf ISO had always worked, but whom staff had <u>not</u> thought of -- or treated -- as individual customers. The opportunity bound up in this challenge involves converting the technical jargon of the actuary -- and often specifically the ISO actuary -- into terms insurer customers (who more often than not are not actuaries) can understand.

This evolution, then, naturally led to a re-evaluation of the ISO organizational structure. From its inception, ISO operated functionally with various disciplines (including actuarial) performing their respective roles. But the emerging customer focus -- where ISO communicates with insurers in terms of specific products and services -- argued for an organizational structure to match that focus. Specifically, ISO reorganized operational areas along business or product lines. After all, many insurers had traveled along the same path successfully. There was every reason to expect that ISO would also succeed.

So instead of an actuarial department separate from line of insurance departments, the actuarial department, _per se_, was absorbed into business units organized around major lines of business and special product areas. In ISO's "core" product areas -- personal lines, commercial casualty, and commercial property -- actuarial personnel work alongside line of business staff, who develop the policy forms and rating rules. Of these three business units, a CAS member leads only one currently.

Beyond the traditional ISO line-of-business actuarial work (i.e., ratemaking) other actuaries, who had pursued actuarial and financial research, were absorbed into a special products department. Unlike the core areas, which are funded by all participating ISO insurers, the special products area has the charge to develop products and services that may appeal initially to only a portion of ISO participants. ISO actuaries working in this area develop products tailored to the specific needs of some insurers. The expectation is that a portion of those tailored products should, over time, become common-good products and migrate into the core product areas.

ISO's data management actuaries provide services to the three core areas and the special products area. As a key corporate support area, though, the question was whether this function should be integrated into the individual product areas -- core and special -- or continue to stand alone. The economies of unified, consistent solutions to data problems and developing new systems outweighed whatever benefits dedicated data management within each product area could offer. This evaluation was not limited to the actuarial data management discipline but included all corporate support functions (information systems, legal, industry relations, communications, government relations).

ISO still has a corporate officer who functions as Chief Actuary. The Chief Actuary assures the appropriateness of actuarial methodology across lines of insurance (and core product areas) and directs the professional staffing and development of ISO's actuarial divisions within the various departments.

The intensified customer focus required the reorganization to include an expanded industry relations department. The function not only is responsible for coordinating insurer participation with ISO, but also for servicing insurer customers through targeted market research, cohesive marketing strategies, and a dedicated client relations program. This expanded focus also requires specific actuarial support in helping to define the research, support the market plans, design electronic delivery, and participate -- when needed -- in customer visits as part of the client relations program.

As ISO settles into the new structure, the change in focus presents developmental opportunities. Satisfying the needs of insurer customers has led to the emergence of a whole spectrum of issues that ISO actuaries never encountered before -- forcing ISO to face them head on, to separate fact from fantasy, and to develop appropriate programs that expand the actuarial staff's ability to deal with other-than-actuarial business problems.

IV. ISO ACTUARIES IN A NON-ACTUARIAL WORLD

ISO actuaries in making the transition from an insulated actuarial sphere of influence to a customer-focused, product-owner, business-unit environment have addressed new issues:

1. **Can actuaries work for non-actuaries? Can actuaries lead business units?**

   Prior to reorganization, ISO actuaries worked for non-actuaries only if they followed career paths outside ISO's unified actuarial department. In the reorganized ISO, some actuarial units report to non-actuaries who lead particular business units. As mentioned previously, ISO actuaries typically talked to insurer or regulatory actuaries or technically-oriented personnel. Internally, actuaries now had to advocate projects to those not as conversant with actuarial terms. The jargon problem hit home immediately. The expectation is that overcoming this "obstacle" should lead to deeper understanding by both the actuaries and business unit heads involved.

On the other hand, some ISO actuaries have become product owners or lead small business units staffed at least in part by non-actuaries. These actuaries are dealing with planning, product development, distribution, and other aspects of product ownership that had few counterparts in the ratemaking realm that they grew up in.

Without formal training beforehand, actuaries and non-actuaries alike are adapting and working in teams to achieve a successful transition. The planning that preceded the reorganization was common-sensical; that is, for example, grouping actuaries and non-actuaries working in the same business unit for the same line of insurance, thus drawing on the natural alliances and strengths in that line. Additional or formal training in specific business applications may be needed.

2. Can actuaries learn marketing skills? Can actuaries sell?

Many actuaries view these questions as the same thing. Conventional actuarial wisdom would hold that communicating an opinion, a methodology, a program is really marketing or selling that item. Yes! And no! The skills necessary to convince an audience of a viewpoint or to sell a particular product have effective communication in common. But ISO's loss cost conversion taught the importance of listening to, learning from, and responding to customers' requirements.

A key element in ISO's becoming a customer-driven organization is the development of an effective client-relations program. And actuarial personnel are participating in that program -- visiting insurer customers, participating in insurer focus groups, learning about insurers' needs, detailing (from the customer's perspective) how ISO products and services -- especially actuarial services and methodologies -- address those needs, and using that customer research to build better products and services.

That process is the essence of marketing, ISO-style; and ISO actuaries are beginning to learn how to do it.

On the sales front, experience has shown that the actuaries who built some of ISO's most sophisticated products (e.g., increased limits software) are the best salesmen of those products -- perhaps because the audiences for these products are primarily other actuaries.

3. Can actuaries maintain actuarial standards while attempting to be responsive to customers? How will consistency of ratemaking procedures by line be maintained?

With an actuarial department rèsponsible for a function, but not products, it was easy to be a purist. But product owners might be tempted to sacrifice some actuarial precision to make a product more responsive to customer needs -- or at least that was the hypothesis. It didn't take long to recognize that each product (whether it be loss costs, rules or actuarial services) could only have value if the actuarial techniques underlying it were reliable. Without actuarial integrity, the product was worthless.

As for ratemaking procedure consistency, the Chief Actuary has responsibility for coordinating the ISO Actuarial Committee, composed of senior actuaries from participating ISO insurers. Part of that committee's responsibility involves reviewing and evaluating (not approving) the rationale for differences in procedures by line of insurance and advising staff of the impact of such procedures.

4. **Can an actuarial program with 200 participants be administered without a unified Actuarial Department?**

The question arose because virtually all ISO's actuarial staff begin their careers immediately after college. They have been trained and developed within the ISO Actuarial Department. Getting approval of new product heads on hiring priorities and cross-training of individuals (expanding their perspective by transferring them to new areas with different responsibilities) was viewed as a potential obstacle to be overcome.

An internal steering committee, headed by the Chief Actuary, established guidelines on recruitment, training and development, cross-training, CAS meeting attendance, and even actuarial exam performance standards and raises. While staff has become more concerned with enhancing products, increasing customer satisfaction, and learning new job skills, this actuarial department administration assures consistency and completeness in the training and development of ISO's actuarial assets.

V. CONCLUSION

This brief summary should provide some insight on how far ISO has come in its evolution from a common-good, ratemaking bureau into a customer-driven service organization. What should be clear, though, is that this change is only beginning -- there are still significant strides that ISO must make in becoming more business-like.

Just as actuaries, as a profession, have long focused on the liability side of the balance sheet and are now paying greater attention to the asset side, ISO actuaries must learn about the "asset" side of ISO's business. They will need to learn how to forecast revenues better because ISO is changing how it charges for services. Instead of an "assessment" basis where what insurers paid ISO for services rendered changed from quarter to quarter as costs and insurer participation changed, ISO is shifting to a revised pricing structure to give insurers greater certainty about what they pay ISO.

And new customers loom on the horizon as well -- producers certainly and perhaps independent actuarial consultants.

Automation -- a topic that this paper has not addressed -- will play an important role in the continued evolution of ISO and the property/casualty insurance industry that it serves. Whether robots can replace actuaries remains to be determined -- particularly in the area of expert systems.

Turning a bureau into a business -- a challenge! Watch for future chapters.