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A SIMPLE INSURANCE STRATEGY FOR THE FUTURE

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A SIMPLE INSURANCE STRATEGY FOR THE FUTURE

Ignacio Hernando de Larramendi
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Dear Friends,

1. In very broad terms, the main elements of the insurance market are: primary insurers or risk-takers, intermediaries and reinsurers. There are, furthermore, others with internal importance: specialized lawyers, actuaries, economists, risk managers and adjusters, who work within their recognised fields of specialization, in co-ordination with persons from one of the three main areas given above.

There is, however, an important division amongst the risk-takers, whom I am representing here alongside my colleagues on the panel, who represent reinsurers and intermediaries. On the one hand are the pure risk-takers, (if you will excuse the expression), mainly Lloyds and the new American Exchanges, and on the other, the general risk-takers, who, apart from bearing risks, organise production and payment for losses. And even within these two categories, a further distinction can be made between institutional insurers, the 'giants', at least in their own domestic markets, with a high degree of stability and general leadership which entails social responsibility, and the limited insurers who either only service one technical or geographical area, or who are just starting up, or who are small in size, which does not necessarily mean low in solvency. Of course, there is yet another category too: the multinational insurers with affiliates and delegations in many markets. They are normally market leaders in their original market and are very predominantly national insurers.

If the figure of the primary risk-taker takes many forms, so too does that of the intermediary. This term covers a range from the small local captive intermediary to the international broker with highly sophisticated technical services. And the term 'reinsurer' ranges from those who merely take on a small share of risks to the worldwide reinsurer whose functions are equivalent to those of a large Merchant Bank.

But even after all these qualifications, and at the risk of seeming rude to my colleagues, I would go so far as to say that the primary risk-taker is the mainstay of our profession, a real 'prime contractor' who uses intermediaries and reinsurers to achieve his ends, but who bears the final responsibility towards the client for the entire cost of handling their business.

My own position within this scenario, is that of an 'institutional insurer', a leader in our domestic market. This may well affect my point of view and it seems only fair to warn you of this. But in all countries it is probably companies like mine in each country which have to bear the responsibility for strategic answers of great importance not only for the insurance market itself, but also for society as a whole.

Modern society is the outcome of scientific and technological advances in a free world, and new individual and collective risks are constantly arising within it, for trade, industry and public bodies. Lack of protection from such risks would damage the delicate internal social equilibrium and the degree of individual liberty to which we have grown accustomed. Consequently, if we risk-takers want to build a dyke against the growing, potentially 'destructive' pressures which threaten the society's welfare and stability, we must offer a flexible answer, suited to new situations throughout the world and to the specific forms they take in each country.

2. Most people seem to expect these strategic answers to be complicated and entail the application of sophisticated management techniques, original marketing formulae and systems which can only be worked efficiently by bright young executives with masters degrees from prestigious Business Schools whose starting salaries are beyond the wildest dreams of the simple 'clerks' of the old guard. However, I beg to differ. Our answers, if they are to be efficient, should be simple. They should be based on common sense, even though they will, of course, take advantage of the latest computer techniques which are becoming increasingly accessible to each and every one of us.

The 'strategic answers' which should be offered by insurance are: product simplicity, minimum bureaucracy, and ruthless elimination of unnecessary costs, such that we can offer our clients "quality goods at bargain prices" with efficient, reasonably-priced service. This, however, simple as it may appear, is something which is all too often forgotten, although companies can be found in most countries who do indeed bear it in mind and, as a result, grow in institutional power until they force others to follow their example and thus influence the "overall market quality" and its constant adaptation to new needs.

I expect that you are waiting for me to say something more than this, although what I have just said could easily conclude my contribution today, summing up, as it does, the outcome of years of experience in the profession. I have been involved in the creation of a company whose success is based on always having followed these criteria, challenging the myths of 'processes' and 'theories', eliminating the fashionable marketing and planning departments, but rather, concentrating on human beings, on every man or woman working in the company, whatever their position.

But so that you do not accuse me of excessive brevity, I shall go on to make some further comments. First, though, I should state why, in my opinion, risk-takers need answers: "So that our company keeps abreast or makes progress; so that our overall market supplies satisfactory services to meet public demand in free competition with other alternatives; and so that our 'area of institutional influence' reaches further into aspects which are not strictly related to insurance, using our means and possibilities, but without coercion.

3. The risk-takers' aims for the future are (as they should always have been) the following:

i) To reduce business handling costs, eliminating the unnecessary expenses, often anachronistic, which make our premiums more expensive. To this end, we need the following, which, however obvious, is often ignored:

- To simplify operations, making them clear and understandable to the public and easy for our own personnel to handle. This entails getting rid of 'gadgets' which complicate the basic product or service, and give no more than an appearance of greater appeal or of being different from the rest.

- To fight bureaucracy and eliminate duplication in operational processes whose cost is not only unnecessary, but also increase the cost of other processes. Large risk-takers have an inevitable tendency to bureaucratization which often leads to the maintenance and even the growth of useless, obsolete practices. This bureaucratization, which brings up costs and brings down operating flexibility, outweighs any advantages of scale and is a negative factor in the 'age of decentralization', the inevitable consequence of computerization, in which the accumulated errors of years of bureaucracy are mercilessly exposed to the light.

This is the situation facing nearly all risk-takers working on a worldwide level, and I suppose that it also affects those of smaller scale in their domestic market, less noticeably perhaps, but of equal importance to them.

- To oversee the distribution processes and their costs, which are usually higher, sometimes much higher than the rest of the handling costs and where there are, consequently, greater chances for efficiency. This is the unfinished 'glorious revolution' of worldwide insurance, which has been on the march for thirty years, ever since independent risk-takers appeared in the United States and the 'wild' Mutual Companies in France. Both of these stood for distribution simplification and cost reduction, and exerted great influence over the structure of their respective markets. I had the chance of knowing them almost from the start of this process in the United States, and will not try to deny that this has affected my business strategy, since I have been aiming at something similar ever since.
- ii) Decentralization, which, in order to be effective, implies a parallel debureaucratization and new distribution lines, and which is, in itself, an efficient, indispensable tool for lowering costs. I define it as a process of "bringing company decision-making as close as it can be to the place where the service is being supplied, eliminating duplication in administration, concentrating it as much as possible within the unit itself or the operating base". Such decentralization will become easier in the near future, with the explosion in distributed computer technology which will enable companies to take it to areas they had never considered five years earlier, at a low cost. To this end, those companies which are already decentralized will be at an advantage. I know of one insurance company which has been successful by doing quite the opposite, albeit in a small country such as Holland, but they are the exception, as is MUTUA MADRILEÑA in Spain, which is also very centralized.
- iii) Operational flexibility

All the foregoing is very positive, as long as it is combined with the disappearance of costly, unnecessary central services and leads to another indirect advantage - flexibility in operations. This flexibility should not be constrained by bureaucratic processes or by centralistic tyrants who prevent 'grass root' activities which could be speedy and well-suited to the special circumstances in each area or insurance type. It is what stops a great risk-taker from becoming a cumbersome dinosaur and manages to react in the face of competitors'

imaginative efforts, even where these appear insignificant, or in the face of the changing needs for risk cover and other demands from the public which we should serve and not be served by or force to do things simply because it is in our interest. This quality alone, implies a latent strategic answer to any eventuality, and without it no preconceived strategy can be effective.

- iv) Other aspects Apart from the above points, which are mutually complementary, there are other strategic goals for insurance, especially that of turning insurance into a socially positive tool, rather than treating it as a instrument for coercion or for sectorial profit, as some would have it.

Amongst others, I would cite:

- Maintenance of a high level of security in economic compensation, taking into consideration that many of our commitments are long term and that the insured always pays in advance. The insurance policy entails "security of loss perception". If it does not, it cheats its public, and this does not only affect the individual insurer, but also the entire market.

This is why formulas should be recommended, albeit with a certain degree of caution, which, even if they do not eliminate, at least reduce this risk, along the lines of Lloyd's Guarantee Fund, similar to what several financial and saving institutions in many countries use when the mistaken policy of a company threatens the public good. But not even this is enough where the supervisory authorities do not provide sufficient guard for the public or where not enough information is publicly passed on. Even if neither of these can prevent fraud, they can at least stop honest risk-takers from trusting that time will wipe out their mistakes such that they do not need to correct them, an attitude which at times can reduce their clients' wealth bit by bit.

- Maintenance of a high level of product quality. This does not simply depend on the legal terminology being clear or not including any dishonest twists which come out only when the claim is submitted. It depends even more on the risk-taker offering his services in good faith and with acceptable generosity when such good faith exists. The public (except, of course, the specialist cheaters) needs to feel satisfied with the efficiency and speed with which they receive their indemnity following a claim. This could be achieved through an ombudsman-type institution, to which individual insureds could turn in a simple and natural

manner, and which could keep a watchful eye on the petty corruption which is inevitable in very decentralized organizations, usually for 'personal or local reasons' quite beyond the control of the insurer. But, whatever the case, the final burden for quality rests squarely on the shoulders of the insurance company, who should normally have the means to keep it high.

- Widening of the range of usual covers to complementary services. This is something that risk-takers are able to arrange with better pricing conditions than other companies or institutions, because they are necessary to our own activity and thus have a relatively low marginal cost. This widening out into different areas (which I shall specify later) can represent frequent contact with the public, who thereby get more opportunities to know the insurance world - who the good insurers are, etc. - and are more likely to turn to it.

This also helps us cope with our 'institutional risk of community dissatisfaction', the seed of popular measures against insurance, which are naturally of increasing importance as our relative size increases in the overall size of the country's socio-economic institutions. In a free market, the 'complementary services policy' should not be uniform. Some insurers may place much emphasis on it and be successful, others may prefer the sale of pure economic compensation making their products less expensive as a result. It will be up to the public to decide which they prefer - in just the same way as they do when choosing their television viewing. There may not be any Nielsen report on insurance-choosing behaviour, but anybody with sufficient information can see the dominant trend at any given moment.

I would define the following as the most important complementary services:

- Constant concern to adapt coverage to new risk situations and public demand, avoiding the temptation to follow the law of inertia that allows obsolete covers to be maintained and puts the dampers on innovations which usually demand a lower margin of intermediation and therefore of profit. Lack of interest in innovation, along with bureaucratization, are the two main obstacles to the process of constant social adaptation in insurance activity. The insurers should bear them in mind if they want to survive in the market - especially the institutional risk-takers and market leaders whose advantageous

position may permit them to be less sensitive to the consequences of their mistakes for a long time.

- Assistance in prevention of risk and losses, including life prolongation, in many cases as useful to the insured as economic compensation. This service breaks with the erroneous idea held by some insurers that this is not a suitable function for us and that it even reduces the premium levels to our disadvantage.
- Complementary assistance in accidents or incidents occurring to our insureds, making our organization available to them. In Car insurance, for example, the insureds are glad of assistance at the unnerving moment of the loss.
- Assessment for investment of individual surpluses and fiscal aspects related to them, which are complementary to Life insurance, with its high level of specialization in investment techniques and the taxation aspects of family finance.

Each one of these services, and other similar possibilities, can compete with those offered by other institutions and create an area of competitive friction to the greater benefit of the public. It is clear that it is in the insurer's legitimate interest to bring these areas within the scope of his business.

4. Having laid down our goals, let us now refer to some of the means by which they can be achieved:

- × Genuine concern for personnel. This is the basic principle for a company or a profession's success. Without it, it is impossible to attain internal cohesion, a "company philosophy" which is transmitted to the clients by helpful, contented staff. A team spirit needs to be created, which is incompatible with formal stiffness, privileges or special perks, unless these are in the company's interest or have special reasons for existing. A sort of 'intimate democracy' can only come into being through informal relations, with no rigid rules and regulations. If rules have to exist, they should not dampen the 'company spirit' amongst people working there. This is doubly necessary in a decentralized system where there are hundreds of independent decision-makers who, although geographically isolated, act as full representatives of the company to insureds and third parties.
- × Intensification of the national character. This seems to me to be an integral part of insurance, which can have

political significance if it is used to protect a country's welfare without resorting to coercive means. In my opinion, this is the contribution which free, independent insurance can make to the protection of the autonomous culture of a country and is a reason why insurance is capable of taking on social importance as a tool for achieving internal equilibrium and protection against the influence of other nations or cultures. This could be extremely important if the European Common Market continues to flourish and Spain becomes a full, active member.

- × Capillary logistics. This is the name which we have given in my company to the network of full, direct services which the insured can ask for, so that the company goes to him instead of vice-versa. The logistics mean that he no longer has to move to get insured, and are something which Banks and Saving Banks have achieved in many countries, but which is practically non-existent in insurance.

This 'capillarization' will be necessary to the risk-takers who wish to achieve a certain level of 'institutionalization' in a market. It will become even easier to manage in the future through the use of new technology, especially portable computers. It also constitutes a strategy both for adapting to future needs and for protecting 'domestic insurers' against the big multinationals.

These capillary logistics are intimately related to the distribution system and to the function of the intermediaries in insurance handling, since some insurers find it hard to reduce costs because of their obligations to intermediaries who do not feel compelled to concern themselves with such matters, as if they themselves were not part of the overall process of insurance handling. In other cases, even if they wish to do so, it is often difficult to integrate them in a united commercial and technical function, like that demanded by efficient capillarization. This area is possibly the most delicate in the strategic answer to the needs for transformation of the insurance business. At times this transformation may seem more like a revolution as it tries to confront the technological and sociological challenges of tomorrow's society.

- × Complete, frequent and clear information, both internally and to the outside. This permits full, generalized knowledge of what is going on at any moment and in any part of the company, and enables this to be passed on in an understandable manner to the public and, on the public's behalf, to the authorities. At the same time, this acts as a useful tool to detect and correct deviations in results, as an effective guarantee, better than any other in offering the 'safety' which it is insurance's task to provide. It is also a way of reducing costs, since

frequent comparisons of information, widely circulated, facilitate self-correction of results and eliminate the necessity for a supervisory bureaucracy of non-productive committees and administrative bodies.

- x Own risk management. This principle is of great interest and has been sadly ignored by most primary risk-takers, despite the fact that it is widely followed by the big insurance companies, as is clearly attested to by the example of this meeting on 'risk management'.

It is not only General Motors, Shell or IBM who need their own risk management policy. We insurers need it too - and those of us involved in reinsurance need it even more. We should always be aware of our static solvency, i.e. our solvency at any given historical moment, and of our dynamic solvency, i.e. that which depends on all the different risks to which we are subject and which, at any time, hard to foresee or predict, might alter and substantially weaken an excellent static solvency.

Does this not seem a fitting function for the risk-managers dealing with high sums of industrial wealth, many of whom are listening to me here today? Why are the majority of insurers quite oblivious to their dynamic solvency?

The management of risks in industry is related to insurance protection, but it goes much further than that. I expect to see it move into many new areas of risk, insurable or not, and new measures will have to be taken on the basis of the new, enlarged scope. Risk management amongst insurers is related to reinsurance, but it should be, and indeed is becoming broader day by day since it will inevitably come to cover not just own risks (those we face as a company, along the lines of industrial risks and those taken on by third parties in our insuring function), but also the legal and financial risks, which are so important to the insurers as guardians of the dynamic equilibrium of our resources, most of which are at the service of the insureds, but whose continued existence is the responsibility of the insurance company itself. This new function which is integrated, at least in my company, with a policy of internal control, opens new fields for relations and collaboration with big industrial clients. These clients can teach us new techniques and give us help as well as offering us a new serviceable field, where, if we are in full control of our own risks, we may be able to give advice to some of them.

But above all, risk management must make us able to co-ordinate the 'security' which our promised future loss payments demand, with a minimum cost and maximum efficiency. This will be an important asset, if you wish to call it that, which we can offer the insureds and which contributes towards the achievement of the basic social goal of offering a "high quality service and dynamic

safety, at a socially constructive cost". I believe that this could be another strategic answer, for all its apparent simplicity, needing no more than the humble application of common sense, which no active member of the company should lack.

Now, all that is left for me to discuss is whether these strategic answers, or those which are considered most appropriate, should be implemented collectively, by the market or be the result of independent, competitive activity, especially amongst those companies whose size and 'aggressive, institutional spirit' make them see themselves as leaders.

As a convinced supporter of free competition (by which I mean real competition, not pseudo-competition which discreetly tends to eliminate the real one) I believe in individualized action by those who dedicate their entrepreneurial effort towards service and balanced growth. In general, I consider such action to be more efficient than collective action, even more so if it is carried out by associations which represent widely differing interests which oblige them to constant compromise. My attitude is the same when it comes to support or encouragement from the State or from insurance authorities, in which case competition is affected and the market is weakened, stratified and prevented from being able to react adequately to changing needs.

Naturally, this should not be an obstacle to co-ordination between leading insurers for the purposes of standardized, positive action as long as it does not remove the competition between them, but helps them to be more effective in their institutional action. Such concerted effort is hard to achieve in Latin countries, and this is perhaps one of the reasons why our insurance has not obtained the same degree of penetration and public recognition as it receives in non-Latin European countries.

Finally, may I just add that I gave this talk with the intention of encouraging discussion on the ways in which we can work together towards this individual and collective goal of preparing insurance for the problems and obstacles that the future will bring. We all look forward to seeing the improvement and broadening of the market become reality, and I sincerely hope that Spain builds up an efficient insurance market which enables it to win the trust of both clients and governments and thus permits it to extend its sphere of activities and prepare for fair and honorable competition with our other European colleagues.

Many thanks.

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