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INTERNATIONAL SEMINAR ON  
RISK AND SECURITY MANAGEMENT  
FOR INSURANCE COMPANIES

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9. FINAL DISCUSSION

1. STRATEGY OF TOP MANAGEMENT, SUPERVISION  
AND CONTROL



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I wish to present in a synoptic way an outlook on the risks of the top management (the Chief Executive Officer) who, under whatever denomination, has to adopt the final decisions of a company or of an autonomous group of companies, or at least of some autonomous units within a group.

Such outlook should be the basis for a short written opinion of the participants in the Seminar on:

- \* The description made. Is it excessive or poor? Are the detected risks over or below the reality?
- \* The three specific risks which, in general or in their particular opinion, are more important.
- \* Any other remark.

For the sake of efficacy answers should be written in the enclosed form and delivered at the Seminar's Secretariat before Wednesday evening, in order to start the meeting with a summary of the participants views and thus establish a suitable working method.

## 1. TOP MANAGEMENT AND POWER

The CEO is the person with the highest responsibility of a business unit and he "administers" the power by making decisions so that the Company grows (the Company which does not aspire to grow stops being an active unit and becomes a company in liquidation or transformation).

This power may be unlimited when the sole objective is the "balanced growth to give an efficient service"; or limited when the company, due to the circumstances of its creation or of its shareholders will, has a restricted aim: to operate in only one field or one geographical area, or other specific situation.

Apparently, the Board of Directors limits the CEO's power, but not in fact. Actually, the Board chooses him and entrusts him of the management. In most cases the CEO makes the decisions and submits them to the Board's approval, which usually, is not very deeply studied. This situation is slightly different at the German system of "Supervision Board".

The actual desirable control of the CEO, in order to eliminate the very serious risk of "authoritarianism" is the existence of a "Management Team", Executive Committee or Board of Management which makes it necessary to make as a body and to discuss the decisions with professional persons who feel involved in the success of the operation, though their usual work is focused on only some of its aspects.

The risk also exists of the CEO's lack of power when the Board assumes operative functions and interferes in the decisions, this originating the lack of a "genuine top responsible authority".

Last but not least, the risk of the CEO's weakness of character also exists. This risk is taken by the Board, who is usually responsible of the appointment; the risk of incompetence is less probable.

As a whole, the risks of the CEO and, to a certain extent, of the Board of Directors, are the "risks of being and existing" that no Seminar can remediate but helps to detect.

## 2. THE CEO'S FUNCTIONS

To this Seminar's effects, though difficult to define very precisely, the most important functions can be described as follows to this Seminar's effects:

Strategy.- A Company needs an objective, limited or unlimited, as above stated; and a strategy, that is to say, a choice of means and instruments in order to reach its objective of balanced growth.

The choice among different possibilities always implies risks, small or large, according to its nature and also to the experience of the person who proposes and administers them.

This function, where the maximum operative responsibility lies, corresponds basically to the CEO.

Creation, reform and adaptation of the human team.- A Company is its men and mainly those who accept partial responsibilities, necessary and important.

The team is the basic instrument of a CEO and a mistake in their selection is a high risk for the Company and the highest for the CEO himself.

The most important success of a CEO -and the reason why he is appointed- is to create and head a management team, who, on their turn, create an important human team at all levels of the Company.

Promotion of the operative action.- The CEO must promote the Company's action through the Management team. He must be the engine that pulls and pushes the company's action with his continuous pressure and with his permanent and full knowledge of the company's situation, detecting and correcting the small deviations which might end in future serious problems. It is a task full of prudence and tenacity which mainly requires the quality "coordinator" of men and actions" that a CEO must have.

Company's supervision.- This function is different to the previous (direct personal action, enlivening the Company). The supervision comprises the technical and managerial actions necessary to pilot a company and the immediate detection of present or future, explicit or implicit, deviations.

Such supervision has different expressions but it makes up a unit, even when the main sectors are decentralized.

It must look after the elimination of the past risks, concealment for ignorance, negligence or fraud; and the future risks, actions which may cause problems and that "can only be corrected by avoiding them". That is why the prevention or initial correction is the only way to reduce problems.

Ethical responsibility.- at the Company's behaviour with the observance of the legal provisions and with ethical actions, more and more important in financial companies and large corporations.

### 3. FUNCTION OF CREATION AND PURSUIT OF THE STRATEGY

What is strategy? The selection of options for the optimum future evolution of the Company. These are some examples of possible choices at an insurance company:

- \* CENTRALIZATION versus DECENTRALIZATION.
- \* CORPORATIONS' INSURANCE versus INDIVIDUAL AND FAMILIAR INSURANCE.

- \* DIRECT SALES versus SALES THROUGH GENERAL AGENTS OR BROKERS.
- \* CAPITALIZATION OF EXPENSES versus ANNUAL AMORTIZATION OF ALL COSTS.
- \* HIGH CAPITAL AND OWN FUNDS versus MINIMUM POSSIBLE CAPITAL.
- \* MAXIMUM ABSORTION OF RISKS versus HIGH DEPENDENCE ON REINSURANCE.
- \* GENEROUS DIVIDENS versus HIGH CAPITALIZATION OF PROFITS.
- \* WEALTHY SEGMENT OF THE POPULATION versus MEDIUM OR LOW SEGMENT.
- \* HIGH SPECIALIZATION versus GENERALIZATION.
- \* REGIONAL SCOPE versus NATIONAL OR INTERNATIONAL SCOPE.
- \* RESTRICTION TO INSURANCE BUSINESS versus DIVERSIFICATION TOWARDS INSURANCE RELATED OPERATIONS OR NON-INSURANCE ACTIVITIES.
- \* FIXED INTEREST INVESTMENTS versus REAL ESTATE or STOCK INVESTMENTS.

Each of these choices can be good depending on the case, but they all offer a risk. That is why the following basic recommendations are convenient.

- \* To cover the retreat:
  - If there is a mistake
  - If the market or the society's circumstances change.
- \* To avoid radical strategies.
- \* To prepare an effective plan of pursuit, as immediately as possible, to facilitate tactical rectifications and changes in the strategy.

#### 4. FUNCTION OF CREATION AND ANIMATION

The CEO must be the engine of a team. This requires to know how to create a team.

- Choosing it.
- Motivating it.
- Correcting it.

But a subsequent and permanent action is also convenient:

- Pushing it.
- Supervising it.

That is why the CEO even if he is "olympic" must be dynamic. The main risks of such an action may be:

- The selection (a good choice is the highest virtue of the true CEO).
- The delay in the correction of the selection mistakes.
- The lack of delegation.
- The irresponsible delegation.
- The isolation.
- The excessive interfering.

#### 5. FUNCTION OF SUPERVISION

¿What does it comprise?

OPERATIVE SURVEILLANCE

CONTROL ON ADMINISTRATIVE SYSTEMS

CONTROL ON THE TECHNICAL SITUATION

CONTROL ON MANAGEMENT COSTS

FINANCIAL CONTROL

### OPERATIVE SURVEILLANCE

- Precise knowledge of the evolution of the operations. Visits and contacts are extremely important. Strict statistics distort reality very often.
- Regular and precise information. (Formal).

Formal information is the first management instrument to detect operative risks. It is convenient that information is:

- Monthly and complete (with provisions and periodifications).
- Regarding the global result.
- Obtained two weeks before the end of the period.
- Complemented as far as possible, and with the same frequency, with regard to:
  - . Geographical areas.
  - . Technical areas.
  - . Expenses areas.

An information plan creates some risks:

- Excessive information that nobody understands or uses.
- Insufficient computerised data, not capable of obtaining the necessary or convenient information (to obtain it is a basic target of a CEO).
- Exclusively aimed towards the "top" (CEO and top Officers) and not towards the "bottom". (The more levels the better). Moreover, it must be compared and transparent.

### CONTROL ON ADMINISTRATIVE SYSTEMS

The following points are very important:

- A very well structured accounting.
- The full integration of the accounting into the quarterly and even monthly budgets.

- The detection of operative deviations (funds administration, dangerous decisions for the future) and adaptation of computerized systems to this end.

To these risks of insufficiency and defective structuration the risk of fraud can be added in the use of the information, specially at the most decentralized structures.

#### CONTROL OF THE TECHNICAL SITUATION

Setting up some systems to detect easily:

- Deficient selection.
- Insufficient evaluation of claims.
- Causes of deviations.

#### CONTROL OF MANAGEMENT COSTS

Costs are not sufficiently looked after. Their deviation is not valued if the global result is positive. The future competition of the markets will be based on the level of costs. The CEO must master costs in order to succeed in the Company's survival. A basic risk of the CEO is not to foresee the probable evolution of costs nor the repercussion on the technical balance.

#### FINANCIAL CONTROL

To detect immediately:

- Excess or lack of liquidity.
- Sufficient investments for future engagements.
- Quality of the investments.

Deficiency in the financial management may harm a brilliant technical management if the CEO had concentrated in this and forgotten the former this and the inverse situation being a risk.



## 6. FUNCTION OF THE ETHICAL CONTROL

The ethical risks are more and more frequent at a company: actions against the legal provisions (infringement of the Law); fraud or abuse on clients; forbidden investments, particularly in Life Insurance which administers other's funds which belong to the policyholders or on which they have special rights.

A special sensibility must exist towards this risk, intensified by recent scandals of financial manipulations that border the crime and that may occur in autonomous areas of the company or in subsidiary companies.

Ethics at a Service Company is a part of its "operative quality" and if it does not exist or is insufficient, the company suffers increasing financial losses.

The ethical risks affect to the growing responsibility of the Board of Directors and constitutes an importante area of the CEO's responsibility, who has to take steps to avoid them.

The ethical risks due to actions which do not come to be criminal are important and exceed what is now contemptuously called "prudish morals". There is no stable institutional company (as Insurance companies must be due to its own nature) without a high ethical level which, though may harm results in the short term, contribute to the image of reliability and honesty that an insurance company must have. The reputation and prestige of a serious company may be lost because of anti-ethical behaviours.

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QUESTIONNAIRE

REGARDING MR. HERNANDO DE LARRAMENDI'S PAPER  
"STRATEGY OF TOP MANAGEMENT, SUPERVISION AND CONTROL"

1. Do you consider the description of risks complete?  
Do you think some other should be added?
  
2. Please determine the three concret risks on which discussion would be convenient whether due to its general interest or to your specific interest.
  
3. Other remarks.

Name \_\_\_\_\_

Company \_\_\_\_\_

Country \_\_\_\_\_

PLEASE DELIVER THIS QUESTIONNAIRE AT THE SEMINAR'S SECRETARIAT  
BEFORE WEDNESDAY EVENING.