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CONSULTING ACTUARIES

Professional Status

How is the professional status of consulting actuaries affected by the following?

A. Business-promotion activities;

B. Working relationships with brokers, agents, and nonactuarial consultants;

C. "Competition" with other professionals;

D. Performing services other than "actuarial";

E. Ownership of stock of, or board membership in, particular clients;

F. Billing practices?

What does the public think of consulting actuaries? How can their public relations be maintained at a high level or improved?

New York Regional Meeting

MR. JAMES H. BRADDOCK: Although the term "professional status" has always sounded just a trifle stuffy to me, it is important enough in the consulting field that it should require at least Associateship and preferably Fellowship in a recognized actuarial body, plus thorough job training and job experience.

Business-promotion activities such as descriptive brochures are keyed rather low and do not impair the actuary's position. Many firms do not solicit for new business at all. At Alexander & Alexander, we get most of our clients on a referral basis from other clients, banks, insurance companies, and our own offices across the country.

If one of our general production men finds a company with a pension problem, one of our actuaries makes a call and discusses our services. We enter into a free discussion of possible solutions to the company's problem. This is a professional approach, and we have never had any problem about professional recognition.

Naturally, we work closely with the brokerage end of our own business. Although we have been approached by outside brokers, agents, or other nonactuarial consultants from time to time, we have insisted on direct contact with the client involved. We feel strongly that proper actuarial advice requires the consulting actuary to deal with his client personally, and not through a production man, account executive, or banker. With our 15 qualified actuaries in the U.S. and Canada, plus 4 Fellows in a related French-Canadian actuarial firm, we have a sufficient staff to implement this concept.

We always defer to a client's attorneys in document drafting, letters to the IRS, etc., but try to make sure that an attorney doesn't write technically deficient wording. In actual fact, most companies (and their attorneys) prefer that the actuary write the pension plan. We have even been asked by attorneys to prepare trust agreements, and have done so.

Other professionals might be considered to include accountants, some of whom have original ideas about charging against a company's profit amounts in excess of the actual payments to a pension fund. In one case we have recommended minimum deposits to a company with a tax loss, until the loss carry-forward was used up and taxes became payable. This recommendation was also influenced by the fact that no employees were due to retire for at least 10 years. However, their accountants charged the company for a 25-year funding of the past service liability. This seemed unrealistic to us.

Any of our actuaries who are impressed with the business prospects of a client company and buy some of their common stock do so as individuals, and it is difficult to see how this could impair professional status. It may be the general impression that consulting actuaries are all wealthy men, but those of us who are in the consulting field know that there is little possibility for an individual consulting actuary to obtain a controlling interest in a company, at least if any substantial funds would be required.

Board membership in a client company is undoubtedly a rarity. No such accolades have accrued to any of our large actuarial staff, but I believe we should encourage acceptance of any offer of board membership and think that this definitely would enhance the prestige of the actuary with his client and also the prestige of our whole staff.

The final question on professional status has to do with billing practices. It would be a great relief if we never had to send out invoices, but it's the only way we can eat. However this is the one area where occasionally there is a complaint by a client who does not appreciate the fact that professional actuaries are specialists with years of training and experience who command rates of pay higher than the clerical level. Such instances are rare, but always disturbing, particularly in our case, since our fees are determined on a strict time and expense basis and are comparatively low. Happily, almost all our bills are paid promptly and without question so that the problem is really not a serious one.

It is very gratifying to find that the public in general hold actuaries in high regard. It is very satisfying to have the top officers of a client company or a prospect refer to you as an expert and follow your advice in matters which have a substantial effect on the finances and the employee relations of their company. In my opinion, there has been a continuing improvement in the public relations of consulting actuaries and, in fact, all actuaries. The efforts of the Society of Actuaries to publicize the profession are of considerable help. But as far as consulting actuaries are concerned, I feel that the most constructive approach to the maintenance and improvement of public relations is for them to conduct their business on a high ethical plane, to work accurately and conservatively for their clients, and to comport themselves on a conservative professional basis in their personal contacts with clients and with the public in general. Happily, the overwhelming preponderance of consulting actuaries follows these precepts, and as a result their prestige and public relations inevitably will continue at the present high level and will improve further in the future.

MR. DONALD S. GRUBBS, JR.: The desire to avoid starvation will often prompt a new entrant in the actuarial field to move actively into business promotion. Even well-established firms may choose business-promotion activity to achieve more rapid expansion than they would otherwise have. If the actuary himself does not wish to promote the business actively, he can employ nonactuaries or develop relationships with brokers, agents, and nonactuarial consultants and banks. If properly done, the negative effect on professional status may be minimized.

Competition probably helps keep all of us on our toes, resulting in better service and reasonable fees for our clients, which is good for our professional status. Competition which involves undue price-cutting or criticism of the competence of fellow actuaries hurts everyone. The charging of unreasonably high fees can also damage the professional image.

MR. SAMUEL N. AIN: To my knowledge, this is the first time that an opportunity has been made available under the Society's auspices to discuss, on anything other than a superficial level, aspects of professional conduct.

Problems of professional ethics among actuaries employed by insurance companies or governmental agencies are quite different from those of actuaries who themselves offer services or are employed by firms that offer services to trustees of pension funds or to firms not engaged in insurance activities. In fact, most actuaries appear either to have no interest in these problems or not to comprehend them. As a result, the tremendous growth in the actuarial consulting field has not been accompanied by the development of a suitable or enforceable code of professional ethics to protect the interests of the public.

It is to protect the interests of the public, the actuarial bodies in the U.S. say, that they now seek to establish the Academy of Actuaries. However, the public interest will not be served unless its formation is paralleled by the development of a suitable enforceable code by actuaries themselves or by the imposition of one by a governmental agency.

That there is need for such a code to protect the public should be apparent to any consulting actuary.

We all know that there have been questionable methods of client acquisition and of business operation by qualified practitioners. These have even included actuarial techniques raising serious questions of soundness. However, these activities have been excused by some on the grounds that competition by nonprofessional firms, or by unqualified persons calling themselves "actuaries," necessitated them.

I suggest that we consider the standards of the accounting profession as guides. Since a CPA must deal directly with his client or through another person who is in turn a CPA, he cannot limit his liability by the formation of a corporation. The ownership and control of his firm must be in the hands of CPA's. In order to avoid a conflict of interest, and the appearance of a conflict of interest, he doesn't own stock in his client's business and he doesn't stand to profit from the sale of a product on which he is called upon to make an independent professional judgment.

At present, the practices under which pension consulting actuarial work is being done leave much to be desired. Much work is done, both openly and secretly, which utilizes actuarial services for the sale of funding agency products and services. In other cases, businessmen and members of other professions have found the hiring of actuaries beneficial in developing business in their fields. Many laymen have found the actuarial fields to be a profitable entrepreneurial activity.

The question I would like to ask is: Which of the cited standards of the CPA's code, when applied to actuaries, can be disregarded as not being necessary to protect the public's interest? Can we safely modify them and still protect the public?

MR. GEOFFREY N. CALVERT: In dealing with brokers, agents, and nonactuarial consultants, I believe that the professional status of the consulting actuary is best protected if a number of basic conditions are met. First, the professional actuary should have direct consultation with the client, both in discussing the problem to be worked on and in delivering the report and recommendations. Second, the total fee charged to the client should be known to the professional actuary and should be reasonable. It would seem preferable for the actuary to furnish an invoice directly to the client and not to any intermediary who brings him into the case.

As to competition with other professionals, I would prefer to think of it as collaboration with public accountants, attorneys, investment counsellors, and others with whom the actuary may find his functions interrelating or overlapping. We do not believe that other professional men are capable of doing the work of the actuary. We believe that friendly relationships and full discussions are always constructive, and we have made a practice of fostering these relationships.

I do not feel that the professional status of the actuary is in any way impaired if he finds his activities extending somewhat outside the area of work which could not be performed except by a qualified actuary.

In firms which provide brokerage, as well as consulting actuarial services, situations do arise from time to time in which a portion of the brokerage commissions might reasonably be used to meet the cost of consulting actuarial work. In these cases I believe that the client should be aware of the situation and that the total compensation of the firm providing the combined services should be reasonable, in the sense that double compensation should be avoided. However, the relationship between the actuary and the client should continue to be basically on a fee basis, with a suitable adjustment in the amount of fee, where commissions are more than enough to cover the cost of brokerage services.

MR. SAMUEL ECKLER: In Canada we have recently replaced the Canadian Association of Actuaries with the Canadian Institute of Actuaries. A Fellow of the Canadian Institute of Actuaries will be a Fellow of one of the recognized actuarial organizations or will be an Associate of one of these organizations who has completed 10 years of satisfactory experience. We hope that the various provincial and federal statutes referring to actuaries will be revised so that they will now refer as well to Fellowship in the Canadian Institute of Actuaries. We are also surveying the question of licensing.

The question of professional services is a personal one between the one rendering the service and the person or corporation receiving this service. Even though the billing may be on a corporate basis, there must be a personal confrontation between the professional person and the recipient of the service. Difficulties may develop where there is an intermediary. I like to think a greater emphasis will be put on this personal relationship. Pride in our profession and in the service we are rendering to the public will help lead us to this personal involvement.

The opening speaker said there was nothing wrong in being a director or shareholder of a client. Although we must look at each situation separately, it is a difficult problem. If one is even a minor shareholder in a small stock insurance company, there is a problem in giving proper professional service which we cannot ignore.

MR. WILLIAM A. DREHER: I would like to add three comments on this topic.

An actuary need not practice his profession only with other actuaries if he is to uphold and advance the status of our profession. However, in my view he must have a meaningful role in the management and administration of the actuarial practice of his firm or employer. The Conference of Actuaries in Public Practice has taken a tentative step in this direction by discussing a requirement for its senior membership that the actuary have a position in the management of his firm. In this connection there should be no doubt in his client's mind or in the minds of the actuary's business associates that the actuary is responsible for advice on matters within his professional competence.

I can conceive of situations where an actuary could own stock in a client company, including a small life insurance company, without any impairment of his professional independence. (With respect to the small life insurance company, it might not be too palatable if those clients in whose companies he owned no stock became aware of these stock interests.) However, I do not believe that an actuary should make management decisions for his client; he should confine his role to one of advice and consultation. This being so, it would seem impossible for an actuary to become a director of a company that relied upon his professional services. This view was recently taken by the SEC. One of our clients, in the process of registering shares with the SEC, was obliged to retain another consulting actuary because the actuary who had been serving the company was a board member.

Despite the Society's motto, appearances may become more important than facts. This possibility can become pertinent if a firm providing actuarial services receives compensation partly in the form of commissions from group insurance or annuity contracts and partly in the form of fees. Although it has not created a problem within my own firm—primarily because the total cost for our services has to date exceeded any commissions that might be payable and, furthermore, because a number of insurance companies have indicated a willingness to charge either no commissions or only nominal commissions when dealing with an organization like ours—this practice may require explanation and could create a misleading impression about our professional independence.

MR. MELVIN L. GOLD: Any consulting actuary who is active in the small life insurance company field finds himself dealing with agents or other insurance people familiar with actuaries. He does, however, get involved in areas other than actuarial, such as sales, investments, or mergers. Sometimes the actuary must be the voice of conservatism in spending, particularly where the company officers may not wish to subject themselves to this discipline.

Many newly formed companies desire the consulting actuary to buy some stock so that he will have a stake in the company and give it his best possible attention. Unfortunately, the sale of such stock by the actuary for normal purposes can cause unease among the company officers.

The consultant should never even consider going on the board of a small company because he must often appear before the board as a consultant and he can't wear two hats at the same time.

Denver Regional Meeting

MR. WILLIAM M. BUCHANAN: Turning to the question of what the general public thinks of actuaries, it is probably true that the general public is little aware of actuaries. In my experience, working primarily with small life companies which are frequently quite sales oriented, the actuary is usually considered ultraconservative, highly theoretical, very impractical, but probably a necessary evil and a man for whom one should have a great deal of respect.

MR. J. ROSS ADAMS: The Conference of Actuaries in Public Practice has a reference to the relationship between two consulting actuaries in its Code of Professional Ethics. It states: "The members shall not compete with any other actuary for employment by deliberate underbidding. The member shall not attempt to supplant another actuary unless specifically requested to do so by the clients of the other actuary." At Coates, Herfurth & England, we have adopted a code of ethics which largely follows that of the Conference but is stronger in some points.

MR. THOMAS T. CHAMBERLAIN: Paul Montgomery and I, many years ago, worked out some practical solutions to several of these problems of professional conduct. If a company approaches us to work for them and if we are aware that this company already has another actuary, we do not deal with them unless they have written to the other actuary terminating the service. We do not own stock in any company with which we deal. We meet with boards of directors but do not serve on the board of a client company.

MR. ARTHUR F. PARRY: Business promotion is not too much of a problem for the actuary connected with an accounting firm. We find that the men in the accounting end of our business, in the course of their normal work, find many situations which indicate the need for a consulting actuary, so we are quite busy. Since we insist on working directly with the client, brokers tend not to throw business our way.

MR. RICHARD DASKAIS: Business-promotion activities by actuaries in the employee benefit field are much more widespread than those of recognized professions—accountants and lawyers, for example. I believe that solicitation, mail-promotion campaigns, newsletters, and advertising would violate the ethical standards of the legal and accounting professions.

In the pension consulting field we compete with actuaries of insurance companies which provide a consulting actuarial service as well as a pension product. The insurance companies advertise widely and solicit employers and unions directly. Perhaps our Guides to Professional Conduct should prohibit actuaries from engaging in certain business-promotion activities, and prohibit insurance company actuaries from performing consulting actuarial services for contract holders.

MR. MYLES L. GROVER: In 16 years with Johnson & Higgins, I have never come across any instance where I felt there was any conflict of interest due to our receiving commissions. I am sure all the insurance companies who pay us commissions realize that we are working for the client and not for the insurance company.

MR. WAID J. DAVIDSON, JR.: Consulting actuaries frequently deal with other professionals. Dealings with actuaries can be divided into two areas. When the actuary gives professional advice to an attorney with regard to a court case, the attorney is merely another client seeking his advice. When he is to testify as an expert witness and to be publicly identified with the case, it can cause him certain problems with the opposition in the case, particularly if his testimony is instrumental in getting a favorable verdict. The consultant does have an obligation to supply services so that the attorneys and their clients will not be denied them.

The second area of relationships with attorneys concerns the practice of law without a license. By drafting or assisting in the drafting of legal documents which are part of a pension plan or by drafting policy forms, the actuary can be accused of practicing law. Practicing attorneys are not normally qualified to draft a policy contract, and since the actuary has calculated the rates and values based on certain assumptions with regard to policy provisions, there is rarely any difficulty in this area. Some bar associations, however, have forbidden consulting actuaries to furnish any legal instruments directly to the client in connection with pension plans. This varies from locality to locality. Both attorneys and CPA's are permitted to practice directly before the IRS. Actuaries have not received this privilege, even though in certain areas they are much better qualified then either of the two other groups. I understand one of the benefits to be derived from the licensing of actuaries through the Academy is to permit the actuary to practice before Internal Revenue in cases involving his specialty.

The consulting actuary's relationship with CPA's involves the areas of audit and certification and the area of pension plan costs. In the area of pension plan costs the CPA's have generally conceded that the actuary should determine the normal cost and past service liability. They have tended to reserve the right to determine and audit the actual contribution made. The CPA's have expressed some preference for the entry age normal method of calculation; however, they normally accept any method except terminal funding. Actuaries are involved in connection with audits and certifications in three ways. First, they may be engaged as an independent actuarial consulting firm to render a certification with regard to the reserves. Second, they may be part of a CPA firm and may or may not be mentioned in the certification. Third, there may be a house actuary and the certification may be accepted by the CPA's. The possibility also exists that the CPA's will audit the reserves. Where the actuary is called in as an independent consultant to certify to the reserves, there are several problems which he encounters. If he does a thorough and complete job, it is relatively expensive and he may uncover additional reserves which must be set up. If he does a cursory inspection, he is not likely to find any problems. The company which pays his fee will not be inconvenienced by the finding of additional reserves, and the consultant can easily charge a higher fee in proportion to the time spent than if he does a thorough job. The CPA's have virtually solved this problem by the following methods:

A. Refusing to quote prices for audits where the company is using another firm.
B. Following a standard audit procedure which results in a minimum variation in charges.
C. Charging a higher fee for the first year that they audit a company because of the extra work in learning procedures and setting up work papers.

This problem in connection with certifications is one which the actuarial firms must face and resolve.

The Securities and Exchange Commission has included in its requirements a certificate with regard to page 6 of the annual statement and also the insurance in force. A certification to the accuracy of the information on page 6 is rather difficult because many of these items are approximated by the actuary. Maybe the Committee on Blanks will eliminate this page from the annual statement. Certifying insurance in force is difficult because of the diverse practices of the companies regarding policies where the amount of the insurance varies. The difficulty of certification for these items is sometimes difficult to communicate to a CPA.

Dealings with insurance agents and brokers are sometimes quite difficult. The consulting fees received by the consulting actuary are essentially the same thing as the first-year and renewal commissions received by the agent or the broker. The agent, through his home-office actuary, is able to provide consulting service to the client as a part of the purchase of a group annuity. Some agents will claim that if the plan is placed through him with the company, no consulting fees will be incurred. However, actually similar expenses will be charged through the experience refund or dividend formula as well as home-office expenses incurred in connection with other cases not sold.

The actuary's understanding of all the facets of the life insurance company business qualifies him to engage in management consulting. He can advise on electronics and other systems changes. He can help establish profit objectives and long-range plans. He can help in sales-promotional material. He can assist in merger negotiations. He can give advice and counsel to those contemplating the formation of a new company. He is in an excellent position to determine the relationship of stock values to the real value of life companies. With the help of computers, the consulting actuary spends much less time on the mass calculation of rates and values and pension valuations so that he can turn to more productive and complicated areas. In the field of employee benefits he can develop an integrated plan providing for all the needs of the employee. He must remember, though, that he should not wander so far afield that he claims to be an expert in an area where he is inept. This damages not only himself but the whole profession.

MR. RAYMOND F. HOUSEMAN: There are four qualities which affect a consulting actuary's professional status in the pension field:

1. Technical competence in the consulting actuary's field of operation.
2. Ability to apply technical knowledge to practical problems.
3. Ability to communicate such technical knowledge to other persons.
4. Ability of the consulting actuary to identify himself with the client's interest with no conflict of interest between his responsibilities to the client and his responsibilities to himself.

The consulting actuary's ability to apply his practical knowledge will include making an accurate appraisal of the client's needs and objectives; finding a solution which will best meet such needs and objectives; describing a solution to the problem to the client in such terms that he can understand how it meets his needs and objectives; and implementing the solution upon obtaining the client's consent to proceed. His duties also include the unscientific function of taking a firm stand, when the occasion demands, to prevent the following of an unsound practice.

The actuaries assist the attorney and the accountant in their areas of concern, but they must not make representations in these areas. The attorney, for example, presents a case before the Internal Revenue Service even though the actuary may have prepared a major portion of the material and arguments. The accountant has final authority as to the manner of showing the funded position of the pension plan in the company's balance sheet even though the actuary has provided and explained the figures. Good judgment dictates that the consulting actuary also play an assisting role in the particular fields of other professions.

The most recent development raising the question of professional status of actuaries and a possible conflict of interest problem is the acquisition of an actuarial division by accounting firms. It is my understanding that the principal reason for an accounting firm to acquire one or more consulting actuaries on its staff is to enable the accounting firm when auditing the accounts of a life insurance company to be able to furnish an unconditional certification covering the actuarial reserves as well as the other liabilities and assets. A consulting actuary who joins an accounting firm may have equal status with the accounting members of the firm in accordance with a written agreement, but in practice he may be at a disadvantage in maintaining such status where there is a difference of opinion. To justify the overhead associated with the acquisition of an actuarial division, an accounting firm will tend more and more to extend its field of operation to include actuarial services. This could lead to pressure from the accounting members of the firm to take over the actuary's former functions of consulting with top management of the clients on pension matters and relegating him to the area of preparation of reports and calculating cost. Such a development would have an adverse effect on both the professional and financial status of the actuary.

MR. LAWRENCE MITCHELL: In every case in which I have been called in as a Group insurance specialist in my brief consulting career, the client of the original consultant knew I was brought in. We discussed with the client the way in which he wanted to be billed, and he understood clearly that he was still the client of the other consultant.

MR. DORRANCE C. BRONSON: If requested by another actuary, a lawyer, bank, accountant, etc., to help in a specialized situation for one of their clients, I would prefer to present my findings as an *individual*, i.e., as a co-actuary or co-expert, in a signed report addressing the ultimate principal. If this were not feasible, it would seem important for me to know that the other intermediary had included, for the ultimate principal, essentially what I had prepared.

MR. EDWARD J. MULLEN: It is our opinion that actuaries and actuarial firms should not directly and openly solicit business any more than other professional persons and firms do. We are aware that if we merely sit in our offices waiting for business to come in, we are not likely to expand according to plan. We run a "business-card" type of advertisement in one of the weekly trade journals and another in one of the monthly trade magazines for our insurance management activities. In employee benefits we do no advertising, but we sponsor and conduct educational seminars among our prospective clients and continuing clients. Our actuaries and consultants do attend industry meetings to keep abreast of developments in the insurance field and to give us an opportunity to see insurance company executives who might use our services. Our pension actuaries and consultants take active roles in the seminars of the American Management Association, the American Bankers Association, the National Foundation of Health, Welfare, and Pension Plans, the Municipal Finance Officers Association, and others of a like nature. We are aware that these meetings are a source of new business as well as a service to the industry. We are on the alert for firms which may be interested in a merger, which would probably fall into the classification of business-promotion activities.

We work only on a fee basis, normally for an employer. We represent him alone, regardless of the interests of a broker or agent. Our work brings us close to certified public accountants and lawyers with whom we cooperate fully, but the client-consulting actuary relationship is paramount.

We do not approach the clients of other actuaries, but we do not feel we should apprise some other actuary that his client has approached us. After all, the client should be free to change actuaries if he wants to, and he wouldn't have come to us if he didn't feel we could serve him better than his last actuary. We feel our clients are free to seek out another firm, and we don't expect to be forewarned to conserve our business.

Some of our assignments might be considered nonactuarial. We have as a subsidiary a computing company which performs all kinds of electronic data-processing, actuarial and otherwise. We do not promote the sale of insurance companies. This is for brokers to do; our function is to place a value on the business for the prospective purchaser or seller or both.

Another activity which might not be entirely actuarial in nature is communications. Letting employees know what benefits the company is providing and giving them information as to what they as individuals are getting from a plan is important. It is part of the obligation of the consulting actuary to the client.

We are entirely opposed to owning stock of our insurance company clients or serving on their boards. First, there is the conflict of interest aspect. The actuary can hardly have an objective, impartial position in an advisory capacity to a company when he owns stock in it or sits on its Board. Second, we feel the actuary should not be serving one client when he has a personal interest in a competitor client. Third, when an actuary with an intimate and expert knowledge of a company's doings buys stock in one new company and does not do the same in a second new company, the public is likely to impute something wrong with the second one.

All our employees keep time sheets. The charges are accumulated daily and tallied at the end of each month. The final figures go to the consultant who makes whatever adjustment he deems necessary and proper. Most of our insurance company clients are on a monthly retainer which covers the normal charges; this would not be true of our pension clients whom we bill on the basis of accumulated charges. Special work outside of what the retainer is intended to cover is billed when necessary. We try to estimate what a special project will cost, and we stand by any commitments made to the client. Our billing is done monthly from a central billing location.

MR. BRONSON: I would like to make one comment on what we generally look upon as nonactuarial activities. Many actuaries of Great Britain perform a considerable amount of work in the field of investments, investment analysis, advising on portfolios, preparation of market indices, and so on. They view this as being within their natural actuarial ambit.

MR. STUART A. ROBERTSON: On a personal level, the question of professional status can be resolved for me by simply stating that my own is not affected by ownership of any client company's stock or by membership on the board of any client. I could add further that essentially the same statement could be made by any of the principals of the firm with which I am associated. However, I should like to extend the subject beyond this purely personal level. Regarding the relationship of the life insurance company consultant to his clients, the highest level of professionalism requires him to minimize all conflicts of interest, since they cannot be entirely eliminated. The fact that we cannot totally dispel them does not excuse us from making the most diligent efforts to overcome them. A financial interest in the success of one client and the absence of that financial interest in another seems to me to present a very clear conflict of interest, and it is one that is easily avoided. I see a similar conflict with respect to ownership of any life company's stock—client or otherwise. To those who would argue that stock ownership in one or more life companies does not necessarily involve a conflict of interest, we point to the Society's Guide to Professional Conduct, with special reference to that principle which has the distinction of being the second on the Society's list, reading, in part: "The member . . . will maintain high standards of the Society by avoiding even the appearance of any questionable practice. . . ." Having just reminded us, in Principle No. 1 that we are obliged to "substitute facts for appearances," the drafters of our code, in phrasing Principle No. 2, wisely acknowledged that our public image is affected both by facts and by appearances. Thus we must be sensitive to the *appearance* of a conflict of interest even though we may feel that we are quite capable of practicing with an immunity to the effects of that conflict.

The Society has given us wide latitude in our interpretation of the Guide to Professional Conduct. Let me make it very clear that it is not my contention that the Society has ordered us not to own stock in client companies. However, referring still to the Society's Guide, I will call attention to Principle No. 12. This one clearly puts upon us the obligation to make a full disclosure to all clients of our financial interest in any one of its life insurance company competitors.

Board membership, as distinguished from simple stock ownership, enlarges the degree of the conflict of interest. A board member of a corporation, it seems to me, assumes a particularly high level of responsibility to the owners of the company, and this serves to sharpen the conflict that exists when working for the company's competitors.

I have no strong feelings against the pension consultant's ownership of a stock interest in clients under the usual circumstances. I draw this distinction between the pension consultant and the life company consultant on the grounds that the services of the pension actuary influence his clients' policies in such a limited area that any conflict of interest that may exist (or may appear to exist) is too slight to be important. The same cannot be said with respect to board membership; I think even the pension consultant should avoid serving on the board of a client or one of his client's competitors.

MR. CLARENCE H. TOOKEY: I am sure we all interpret the rules and principles and so forth in our own way. I happen to remain on the board of the company I serve, and which I have served for forty years. Each November I furnish them with quite an imposing list of the other companies that I have worked for during the year. Apparently there is no crime in having a conflict of interest, provided you tell everybody about it. Now, as to the reaction of my clients to my being on the board of this company, they boast about it, so I haven't felt that it necessarily involved a conflict. I often think that this conflict of interest problem is so broad that it's dangerous to narrow it down to any one area.

I also pick up a few shares of some of my clients if I think it's a good buy, and I feel in a little better position to judge the value of it than perhaps some of the stockbrokers.

MR. GERALD G. TOY: We at George V. Stennes & Associates definitely feel that we should not own stock or serve on the board of a client company.

MR. MITCHELL: Although I am fairly new in the consulting field, it seems to me that the actuary is thought of frequently more as a calculator than as a consultant. Usually this is by a client who has not had much direct contact with a consulting actuary. In these cases it is expected by the client that the consulting will be done by the management consultants teaching at the nearby universities or employed elsewhere. To me, the consulting part of our job is far more important than the calculating part.

MR. PETER R. WILDE: I think the question raised by Mr. Mitchell is an intriguing one. Many of the companies I deal with seem to feel at times that the consultant does not want to get involved very deeply in consulting. I also think sometimes that they feel the consulting advice is expensive in areas not strictly actuarial. The consultant's image is a good one with these people, and they have a high respect for consulting actuaries.

MR. E. FORREST ESTES: One area which has long been neglected by actuaries and one which might be included in the syllabus of examinations is salesmanship. The basic thing is to tell other people what your job is and how important it is. This is done very effectively in many other fields, such as surgery, dentistry, and law. We should pay more attention to it in actuarial work.

MR. BYRON W. STRAIGHT: I would like to comment on the ownership of stock in client companies. In the fifth life insurance company for which I was employed as a consulting actuary, I invested a sizable amount of money because of an attractive market available to the company. The fact that this was the only client company in which I had invested was used repeatedly by the incorporators to raise the early capital. This raises the question whether a consulting actuary should refrain from investing in any of his client companies or invest something in all of them in order to remove his apparent preference for one. In any case, such investments obviously should be disclosed to all his client companies.

MR. ROBERT C. TOOKEY: Mr. Estes brought up a very good point in the point of communication. When we try to sell, we are trying to communicate. There are three principles of communication that the actuary should keep in mind. First, words have no meaning except as symbols mutually agreed upon by speaker and hearer. Meanings of words keep changing and mean different things to different people and different things in different situations. Second, people communicate with their whole being, not just with words. Facial expressions, features, and tone of voice are often more effective than words. Third, people become angered and embarrassed when words are used that they don't understand. The words people understand are usually limited to the experiences they have had in life. An actuary has been defined as one who influences people without making friends. The only way to overcome this reputation is to strive earnestly to communicate effectively without talking down to your listeners, and, above all, to avoid creating the impression that you were born with a special skill beyond human comprehension.

MR. TOY: For several years we have been actuaries for the state of Minnesota joint legislative commission, which studies public employee retirement plans. Recently, we have disagreed with valuations and cost estimates submitted by some consulting actuaries for certain funds. We tried to communicate in as objective a way as possible, and I believe we convinced them of our position without the actuarial profession losing any stature.

Valuation of Life Insurance Companies

A. How can the consulting actuary be helpful in the valuation of a life insurance company in instances where values are needed immediately and facts are not readily available?
B. Do consulting actuaries routinely supply their regular clients with a value for their own use?
C. Could "standards of measurement" be developed by actuaries, or others, for use in providing bench marks for stockholders and regulatory officials?
D. Is there a need for such standards?

New York Regional Meeting

MR. WILLIAM M. CORCORAN: Although a consulting actuary may be obliged to furnish valuations of the stock of a life insurance company, it is asking too much to request that such values be made in the absence of facts and be done immediately. Such valuation is complex and requires extensive study. Time and facts are necessary to do a good job.

Although we at Wolfe, Corcoran & Linder do not regularly supply our clients with the value of their stock, we do discuss routinely the conclusions to be reached from the annual statements and the progress or lack of progress being made by the particular company.

I doubt that standards of measurement could be developed to provide bench marks for stockholders and regulatory officials even though such standards of measurement would be desirable. However, any extensive study of life insurance company valuations will reveal that there is such a divergence of conditions in the various companies that standards cannot be applied routinely. For some companies a careful study of earnings and prospective earnings will show that Ordinary life insurance business is certainly worth $20 a $1,000, but, for some companies, it is obviously worth more, and for still other companies, it certainly is worth less. Values depend largely upon earnings, but they, of course, will naturally vary among companies by premium levels, particularly, and mortality experience, and interest earnings.

MR. MELVIN L. GOLD: There are different ways of valuing a company. Sometimes it is easier to get an answer in one day than in one month. For example, an investment house may want to know whether to continue discussions with a company about raising money. Sometimes with quick calculations you can determine the order of magnitude of the price of the stock and point out that you do not think the discussions are worth continuing. In other instances, the quick calculations will be of no help and the long job must be done.

The difficulty in routinely supplying insurance company clients with the value of their stock is in the definition of value. There is even considerable difference of opinion of how much a firm listed on the New York Stock Exchange is worth. The projection of future operations for an insurance company, particularly a young one, is a difficult task indeed.

MR. LLOYD K. FRIEDMAN: Last fall an insurance company president returned from a meeting and told me that he had found out that he couldn't possibly afford to spend the amount of money it would require to determine whether a merger he had planned was a good idea. In the first place, he would have to talk to about 10 to 20 companies to make one deal, and a thorough investigation of each one would be beyond his reach.

A precise valuation is necessary if the deal is going to involve a purchase for cash. If an exchange of stock is involved, it might be possible by less exact procedures to come up with the relative rather than the absolute value of the stock. If both stocks are overpriced or underpriced in the same proportion, it will not make too much difference on an exchange basis.

Many times the information we can give a client in connection with a merger is not of a quantitative nature. There may be information about policy forms or other items which would be important in making the decision. If we insist on saying that we must make a complete study before giving our clients advice, they just may go ahead and make the deal without any advice at all.

MR. FREDERICK S. TOWNSEND: A few months ago I would have said that "standards of measurement" could be developed for such purposes but that it was not necessary to do so. However, with the advent of legislation requiring the reproduction of the company's assets, liabilities, statement of operations, and surplus account in the annual stockholders' report, certain practices have arisen which, in my opinion, might make it necessary for actuaries or another group to create standards of measurement for regulatory officials and stockholders.

The development to which I refer is the fact that the reproduction of the summary of operations in the annual stockholders' report, particularly in those cases where it is compared to the prior year's results, presents a bad picture for many companies. In some cases this is due to the age of the company or due to a significant increase in new business writings rather than being indicative of a poorly run operation. A review of over two hundred annual stockholders' reports for 1964 indicates many cases where the president's message to stockholders ascribed the company's low earnings to the cost of writing new business and gave a reasonable explanation as to why this is so. This does not bother me.

What does bother me is the fact that many of these same presidents then went on to tell their stockholders that they should not pay attention to the summary of operations but rather should look at a company's "adjusted" earnings. In many cases the adjusted earnings reported to the stockholders were derived by using standards of measurement now employed by investment houses or consulting actuarial firms in interpreting the earnings of a life company. However, some cases were extreme, and whether or not an explanation is extreme, I am still worried as to the reaction of regulatory officials, particularly the SEC, when they discover that the presidents of many life insurance companies are informing their stockholders that the company realized adjusted earnings significantly in excess of the statutory earnings. Such action on the part of the president, who undoubtedly is a substantial stockholder in his company, would tend to create demand for the stock and push the market price up. I think you may agree with me that in pursuing such activities, these particular company officials are laying themselves open to litigation by the SEC, by the state insurance departments, and by stockholders.

In the case of a new small life insurance company, which incurred a net operating loss in 1964, the president tells the stockholders: "As most insurance stockholders are aware, life insurance company reports are prepared in conformity with insurance accounting principles prescribed or permitted under statutory authority, which are designed primarily to reflect the company's ability to meet obligations to policyholders. These principles differ in some respect from generally accepted accounting principles followed by other business operations in determining financial position and results of operations."

He then goes on to state that "the abbreviated comparative operating statement shown in this report reflects a gain of $400,000 from operations before reserves. Were our report prepared on a cash rather than an accrual basis, we would be able to report to our stockholders a profit of more than $400,000 realized by cash income in excess of cash disbursements." In my opinion, I don't see how a responsible company official can tell its stockholders that they should ignore the increase in aggregate reserves in determining a company's earnings for the year.

Denver Regional Meeting

MR. CLARENCE H. TOOKEY: I have a formula for valuing a company which consists of three factors: (1) the capital and surplus adjusted for mandatory securities reserve, nonadmitted assets and any known excess reserves; (2) the liquidating value of business on the books; (3) the going value factor.

Adjusted book value can be estimated reasonably accurately from an annual statement if one is available. The liquidating value of business on the books depends on gross premium levels and persistency. The latter can sometimes be estimated from the policy exhibit. The going value factor is almost impossible to estimate from one annual statement. It is often called the future growth factor and depends on many things. If present writings are fifty million dollars a year, the net present value of future profits can be estimated as $10 a thousand or $500,000. On a five-year basis this would be two and a half million dollars as a growth factor. The $10 value is a function of rate level, expenses, and persistency and is probably high, except where there is a semicaptive market in which higher rates can be charged.

Only an actuary with considerable experience should attempt a valuation with limited facts available, and he should make it clear that he is using certain educated guesses. In the case of most small company clients the need for valuation of stock arises from merger or sale negotiations. Whenever a company requires a new stock issue to replenish surplus, valuation of the existing stock is required. It is also required before a company can get Insurance Department approval of a price for agents' stock options. Routine projections of surplus are often made, and these require the same procedures and techniques that are required in valuation.

Although standards of measurement may reasonably be set for the adjusted book value and the liquidating value, it is only possible to suggest principles for determining the growth factor. Where there is no history of production, the growth factor should be limited to the value of the charter, which may be the amount of money necessary to organize a company and obtain the product to sell. In California, I have used $100,000 for an arbitrary figure, basing it on the costs of the number of young companies in that state. Where there is a history of production, the present value of the net profit on business written in the next five years can be used as a growth factor. This value must be supported by asset share calculations based on realistic assumptions. Some security analysts have used a multiple of book value for adjusted earnings, but these formulas are quite meaningless when applied to small new companies. A record of past accomplishment is the most important ingredient of the growth factor.

MR. J. ROSS ADAMS: When a stock valuation is required in a day or two, I think it is important to try to persuade the client that he should insist on more time to make his reply even if it means the loss of a so-called opportunity. If you can discover his real purpose for making the purchase or merger, the few available facts may indicate that the objective may not be accomplished or it may cost more than it is worth. The client should be warned about lapse rates; the possibility of special types of policies with hazardous dividend provisions; special commission contracts with certain agents or officers; uncertain tax situations; inability of the seller to deliver the agency force; contested claims; suits by ex-agents, ex-officers, or stockholders and whether the seller's board of directors is split into die-hard factions. I have yet to see a high-pressure case which I might seem inclined to approve.

MR. RAYMOND F. HOUSEMAN: Sometimes when you have to value a life insurance company's stock in a hurry, an upper limit which the value cannot possibly exceed can be arrived at quickly. The asking price is usually still higher so that you don't have to go any further.

MR. WILLIAM M. BUCHANAN: We do not, as a regular routine, supply our clients with a value of life insurance for their own use. We do inform the management of our clients when we establish premium rates as to the discounted value of profits for business produced on given assumptions of mortality, interest, lapse, expenses or other characteristics such as average size, reinsurance arrangements, etc. Then, annually, as we are completing the annual statement, we attempt to satisfy ourselves that the company is operating within the assumptions used in establishing premiums. As any consulting actuary would know, the first quarter of the year is a hectic one and hence these investigations are by no means complete. However, it should be possible to spot any major deviations from the assumptions. Such items are then brought to the attention of management.

Some clients express much more interest than others in such information, and a few of our clients now have us make such reviews on a quarterly basis. We feel this is the only way of knowing whether the expected profit margins established when the rates were set are being generated. If these margins are not being produced, it also guides us to where corrective action is necessary. This same information could be used (and has been on occasion) to determine the hidden value which life insurance accounting does not recognize. Quite often there is much more interest in the market value of the stock than in the underlying value, and this difference between underlying value and market value can be quite great.

The variations from one company to another with regard to the type of business make one "standard of measurement" virtually impossible. Perhaps "standard procedures" for evaluation rather than a "standard of measurement" would be more appropriate. While different standards for each company may seem to be a contradiction, it seems that anything else could be quite misleading. If actuaries follow standard procedures and work with a company over a period of years, a very accurate evaluation tailored to the particular company could be made. The stockholder focuses his attention on the stock as an investment. Regulatory officials, on the other hand, should be interested in solvency and full disclosure.

Pension Plan Investments

What role does the consulting actuary play in relation to his client's pension plan in

A. Selecting an interest rate for valuation,
B. Reviewing investment performance,
C. Determining a basis for asset valuation, including unrealized appreciation?

New York Regional Meeting

MR. ROBERT A. WISHART: At the International Congress in Brussels in 1960 the question of giving investment advice was discussed at a meeting of consulting actuaries. Some of those present felt it was quite appropriate for the actuary to give complete investment advice, while others felt that it was not at all appropriate. I am sure many actuaries could do a fine investment job, provided they spent most of their working hours studying the problem, and in Great Britain and Europe I believe many actuaries spend a lot of time studying the market.

The office with which I am associated has consistently taken the position that we should not take the responsibility for the investments of pension funds. We feel we have plenty of other phases of responsibility and should devote our time and energy to them. Full-time investment advisors should be better qualified to give this advice.

In regard to selecting an interest rate for valuation purposes, the actuary should be the most knowledgeable person to assess the consequences of selecting either too high or too low a rate. He knows the effect of estimated value of prospective benefits and the resulting effect of the contributions required to support them. For an existing fund he should know the actual performance under that fund. For a new fund he should have enough knowledge to assess the approximate return if he knows the likely composition of the portfolio.

The person responsible for making investments should not let his investment judgment be affected by a valuation rate of interest. He should apply all of his knowledge to safeguarding the principal and obtaining the best possible yield, taking into account the nature of the fund with which he is dealing. While the actuary can be helpful, the final decision for investment policy should rest with the persons responsible for investing the fund.

Although the actuary can be of some help in reviewing investment performance by making charts and comparisons with certain established indexes, I doubt that such an exercise tells a complete story. Investment results of any particular fund are so colored by unique characteristics of that fund that a theoretical approach is difficult to apply. In our office we have had several requests to review investment performance. We have not accepted any of these assignments.

Determining a basis for asset valuation, including unrealized appreciation, has been a subject that has initiated a tremendous amount of discussion lately. The American Institute of Certified Public Accountants has been studying the problem of the proper method of accounting for the cost of pensions. I understand that their position is that unrealized appreciation or depreciation in securities should be taken into account in estimating pension costs for accounting purposes. The President's Committee on Corporate Pension Funds released a report in January, 1965, recommending that "a determination should be made by a professionally qualified public accountant with respect to the value of pension fund assets."

The actuary is, therefore, now getting plenty of encouragement to keep his eyes open and pay attention to the value of assets. The actuary should be very concerned if he recommends a contribution to his client that will not be allowed as a tax deduction. He should carefully review the value of assets, including unrealized appreciation and depreciation and make whatever suggestions he thinks appropriate regarding them.

MR. PRESTON C. BASSETT: I am in somewhat of a different position from Mr. Wishart in that I think actuaries can provide a service in reviewing past investment performance.

The actuary can help by developing formulas for computing investment returns. He can help in interpreting the results of any studies. Such interpretation should consider the extent of the influence of the client over the investor's actions, the timing of the contributions, the size of the fund, the degree of risk which the client is willing to accept, the objectives of the fund, and other significant variations.

By this it is difficult to see exactly what the actuary's field of activity might be. Perhaps he can help the client set objectives or suggest avenues for further research.

MR. FRANK LIVSEY: In most cases the interest assumptions recommended by the consulting actuary in a valuation are accepted by the client with little or no discussion. In reviewing investment performance, it is common practice for trustees to calculate the interest yield on the fund. The consulting actuary also calculates the yield on the fund whenever he conducts a valuation in order to check his assumptions regarding the interest rate. The yield is normally calculated by taking assets at book value. In the long run, however, the most satisfactory measure of investment performance and a real yardstick for comparing yields on different funds is the yield, including unrealized gains, based on assets taken at market value.

The consulting actuary is in the unique position of having knowledge of the investment performance of several funds held by different trustees. He is therefore in an excellent position to make suggestions to an employer regarding ways in which to improve investment performance. It is not likely that the actuary will recommend specific investments, but he might reasonably comment on the general composition of the investment portfolio.

The prime responsibility for determining the basis for asset valuation rests with the actuary. The decision he has to make is whether to use book, market, or some other value of assets in the valuation. The method used will be chosen after consultation with the client to determine whether the client wishes to take credit for part or for all of the unrealized appreciation.

MR. NORMAN G. KIRKLAND: For the actuary to look only at liabilities and to neglect the valuation of assets seems to me to be disregarding what we are really trying to do, which is to determine whether the advice we are giving in regard to contribution rates is likely to stand up in the test of time. It is essential that there be consistency of treatment on both sides of the balance sheet. To achieve this consistency, both the assets and liabilities should be valued in the same way.

MR. GEOFFREY N. CALVERT: Selection of an interest rate for valuation is one of the prime responsibilities of the actuary. The rate should be discussed with the client, but the actuary should not be in the position where the client dictates the interest rate.

I believe that the actuary certainly has responsibility for reviewing the investment performance of the fund. I am in strongest disagreement with those who feel that the actuary should confine his attention to the liability side of the valuation balance sheet and leave it to others to think about the asset side.

Denver Regional Meeting

MR. WILLIAM F. MARPLES: I think the actuary must assume responsibility for selecting the valuation rate of interest. He should discuss the rate of interest with his client but should do this in such a manner as to be sure that the decision is agreeable to both parties. The end product of the actuary's calculations is the contribution to be paid by the client and this contribution has to be "reasonable and necessary." The interest rate is an important ingredient in determining this contribution.

There is no question that the actuary should shoulder the responsibility for reviewing investment performance. It seems to me that this falls on him for the following reasons:

1. He had a primary involvement in the original selection of an interest rate so he must compare experience with assumption.
2. In general and with few exceptions, he is the only person concerned with the Plan administration who has the technical expertise to make the review.
3. Often, he is the only person, prior to the publication of his actuarial report, who has all the information needed to do the job.
4. Only the actuary possesses a sufficiently objective state of mind to make the review.

It is most desirable that those who are involved in pension plan investments be impressed with the inadequacy of the actuary's valuation rate of interest as a standard of investment performance. The duty of the investment authority (trust officer, investment counsel, finance officer of the employer, or actuary) is to develop the maximum investment return consonant with adequate security. The key words are "maximum return" and "adequate security." There will be many different interpretations of these. Comparative performance figures should be gathered from other funds. Other figures are available in the SEC releases and the reports on stock performance on the New York Stock Exchange by Professors Fisher and Lorie for the Center for Research in Security Prices, Graduate School of Business, University of Chicago.

The initiative in determining the basis for asset valuation should come from the actuary, since he has the over-all responsibilities for the final outcome of his calculations. He also has the responsibility for seeing that the original aims laid down for investing authority are picked up in practice and that the extent to which they are recognized is consistent with sound practice.

In Great Britain actuaries traditionally play an important role in investment advice. The Institute of Actuaries' position has always been that the actuary is responsible for the valuation of both assets and liabilities in any actuarial report on a pension fund or insurance company. Actuaries are to be found in investment departments of insurance companies and are frequently in control of the investment aspects of an insurance company's activity. There is more than one firm of stock brokers in Great Britain with Fellows of the Institute of Actuaries among their partners and on their staff.

British actuaries are currently using a system of valuing assets on the interest rate on which the liabilities are valued. This is held to be more realistic and certainly involves radical changes in values from the traditional asset valuation bases which are still employed in the United States. Actuaries wishing to study this development should consult papers by Heywood and Lander and by Day and McKelvie in *JIA* and Gilley and Funnell in *JSS*. The latest act relating to "Governmental" pension plans permits them to invest in common stocks provided that their actuary approves each purchase.

MR. THOMAS M. YOUNG: The consulting actuary's role in the selection of an interest rate should be that of an adviser rather than an arbitrary decision-maker, as it should be for the selection of other actuarial assumptions, including the method for valuing assets. Since the Internal Revenue Service still allows a considerable amount of discretion in the determination of actuarial assumptions, the selection of the assumptions should be made by the client after the consulting actuary has properly and thoroughly explained to him the various alternatives and the implications of these alternatives.

During the process of selecting the actuarial assumptions, the client usually will readily adopt the actuary's recommendation on mortality rates, disability rates, withdrawal rates, and assumed retirement age. However, in the consideration of the interest rate assumption, he frequently takes the position in favor of an interest rate related to current investment conditions rather than one which also recognizes historical investment experience. It should be pointed out that we are dealing with estimates 30 to 40 years in the future and that the use of an interest rate conservative by today's standards is not only justified but also highly desirable, and what appears to be conservatism in the interest assumption can be a hedge against the possible lack of conservatism in other assumptions, particularly a salary scale assumption.

In the area of asset valuation, the actuary should point out that the use of book value is in itself arbitrary, but it does produce a certain amount of stability. He should discourage the use of a valuation basis other than book when the unrealized appreciation is only a small percentage of the book value. He should periodically compare, and report to the client, the relationship between the unfunded accrued liability and the unrealized appreciation.

The consulting actuary's role in analyzing investment performance should be one of continued reporting to the client of investment results. With the increased use of computers, the calculation of an exact rate, rather than an approximate rate, is now quite practical and highly desirable. Investment performance, both with and without unrealized appreciation and properly labeled, should be presented so that comparisons with other funds can better be facilitated.

More and more attention is being given to the area of pension plan investments and their effect on the cost of the pension plan. Now that insurance companies have overcome their most severe competitive disadvantages, the decision as to who should hold the pension assets is being resolved more frequently on the basis of anticipated investment return. We, as consulting actuaries, must increase our knowledge of the investment field and our ability to assist the client in his decisions regarding the investment of pension plans. Our knowledge of statistics and of actuarial science already allows us to make some probability statements regarding mortality rates. Some of my friends in the academic world tell me that we may someday be able to make probability statements regarding investment return. Although we may never be able to predict investment performance with the same confidence that we do mortality, any step toward this goal is a step in the right direction.

MR. ROBERT W. GRINDLEY: In reviewing investment results, some principles should be established for the calculation and presentation of interest rates, as follows:

1. The traditional formula $i = 2I/(A + B - I)$ should be used.
2. Uninvested cash should be included in both the A and B of the denominator.
3. A history of rates should be shown if possible; a single year's performance may not be significant.
4. Separate rates should be shown for the fixed income and the equity elements of the portfolio.
5. It should be clear whether
   a) The denominator is market or book value,
   b) The numerator includes realized capital gains, both realized and unrealized or neither, and
   c) The rate is before or after investment expense.

1964 Auto Agreements

What are the problems in valuing and costing benefits of the type included in the 1964 bargaining agreements between the automobile companies and the United Automobile Workers?

New York Regional Meeting

MR. GEOFFREY N. CALVERT: The main problem in dealing with benefits of this type is to determine the allowance to be made or the assumed distribution of early retirements. It may be that even the unfolding of history will not provide too reliable a guide as to the future. The shifting pressures of economic prosperity and full employment on the one hand and depression and unemployment on the other hand, the progressive taking over of human activity by automatic machinery and computers, the relative growth and shrinkage of industries, and the sudden and violent changes in employment conditions due to war situations, and similar changing factors will keep the experience with respect to early retirement in a state of turbulence, in which the experience in one industry will not serve as a guide for another industry; nor will the experience at one time serve as a reliable guide for a later time.

One practical approach may be to adopt a practice of funding the basic pension from a normal or average retirement age with short-term and perhaps year-to-year adjustments or supplements in cost, reflecting current conditions in the early retirement area.

MR. JAMES A. HAMILTON: It may be helpful to list very briefly the major benefit areas where changes were made in the recent 1964 negotiations between the large automobile companies and the UAW-AFL-CIO. These include the following:

1. The benefits of present pensioners were increased by $1.45 per month per year of service (this applies also to the temporary-to-age-65 benefits). There was no change in benefits for the deferred (vested) cases.
2. The basic benefit accrual rate was increased from $2.80 to $4.25 per month per year of credited service, past and future.
3. For corporation option or "mutually satisfactory" early retirements, and disability retirements, the temporary extra benefit was increased from $2.80 per month per year of service to $5.20 per month per year of service (maximum $130.00 a month). This is designed to tie in with the age 65 Social Security benefit (maximum $127.00).
4. Voluntary retirements at ages 60–64 have their basic accrued benefit actuarially reduced from age 62 instead of from age 65.
5. The introduction of corporation option or "mutually satisfactory" early retirement for employees age 55–59 having 10 years of service with benefits payable immediately, unreduced.

6. The introduction of voluntary retirement at ages 55–59 meeting the Rule of 85 requirement (i.e., age and years of service totaling at least 85), with benefits actuarially reduced from age 62.
7. On voluntary early retirements a revised (liberalized) set of reduction factors (extending down to age 55).
8. The J & S retirement option was increased from a 50 per cent benefit to the spouse to a 55 per cent benefit to the spouse (with the 90 per cent employee benefit unchanged).
9. The introduction of a pre-retirement death benefit (payable only when there are no so-called bridge and transition group life benefits) equal to what would be payable to the spouse if the employee had retired voluntarily at date of death and elected the J & S option.
10. A revised definition of total and permanent disability.
11. Full vesting liberalized to 10 years of service (i.e., the age 40 requirement was eliminated).
12. A Supplemental Allowance benefit which provides that the total benefit payable to age 65 will be up to $400 a month, depending on age and length of service (but not to exceed 70 per cent of final monthly pay).

The last of these, the Supplemental Allowance benefit, is a novel addition, the cost of which is difficult to measure. There is no industrial experience to turn to as a guide to the probable acceptance of such a benefit on the part of those eligible to receive it. Utilization will probably be affected to an important degree by economic conditions. Should there be a temporary decline in the demand for the products manufactured by automotive companies, early retirement may seem more attractive to eligible employees whose take-home pay is being curtailed by "short shifts," etc. If there is a lack of available work, then the union may encourage acceptance of early retirement. Automation may have an important effect, but it is difficult to know whether automation will result in smaller or greater employment in the automotive industry.

There is a further problem in providing a funding procedure for the Supplemental Allowance benefit. For regular benefits, the conventional automotive agreement provides for funding of current service or normal costs with 30-year amortization of the prior service deficiency. The agreements stipulate, in effect, that the funding procedure must avoid a cash deficit in the Supplemental Allowance account and that any procedure may be used which receives the approval of the actuary.

There are two ways in which the employee may utilize the Supplemental Allowance benefit. He may be retired early at the corporation's option (or he may retire with "company consent" under conditions that are mutually satisfactory) or he can retire voluntarily. While the total monthly benefit (including Supplemental Allowance if eligible) that he receives under either form is generally identical until he becomes age 65, there is an important distinction between the two types as to separation into regular benefit and the Supplemental Allowance benefit.

From age 60 the total monthly benefit to age 65 for a voluntary type of early retirement consists of the $4.25 basic benefit actuarially reduced from age 62, and the Supplemental Allowance necessary to produce, for 30 years or more of service, a total of $400 a month (subject to the 70 per cent of monthly pay limitation). For the "consent retirement," however, the regular benefit consists of the $4.25 basic part without actuarial reduction plus a Social Security make-up to age 65 or DIB of $5.20 per month per year of credited service up to 25 years, and the Supplemental Allowance is only the residual part necessary to bring this greater regular benefit up to $400 (or 70 per cent) a month for 30 years of service. In other words, for two 30-year service employees who retire at age 60 and receive $400 a month until age 65, the Supplemental Allowance is, for the consent case, $142.50 a month, while for the voluntary case it is more than double, $289.46 a month.

Obviously, if the desire is to try to make any reasonable separation of total annual costs into the current service part and the 30-year amortization part and the Supplemental Allowance part to be funded on the "approved by the actuary" method, it will be desirable to introduce two separate sets of decremental rates of early retirement: one for consent retirements and one for voluntary retirements.

There are many choices of funding structure for the Supplemental Allowance benefit. The funding procedure could follow that for the regular benefits; it could be on the so-called "interest only" basis, or advance funding from a pre-determined attained age, or terminal funding, or pay-as-you-go, or one of the members of the Trowbridge "Unfunded Present Value Family of Pension Funding Methods" (*TSA*, XV, 151), probably with the parameter k set at a relatively low figure.

MR. AUBREY WHITE: The Canadian problem with 1964 Auto Agreements was considerably more difficult than that in the United States. A part of this is a result of differences in Canadian Social Security benefits.

One of the things we did in evaluating the early retirement provision was to compare for each individual his wage rate with the pension he could claim, at every age a pension was available to him. These comparisons were used to develop rates of incidence of automatic retirement which reflected incentive to retire.

MR. NORMAN G. KIRKLAND: The generous U.A.W. settlements have created some problems of comparative benefits with company plans for salaried employees not included in union plans. This is particularly true for the lower paid salary groups.

There is also a problem in connection with those who have retired under salaried employees' plans. The U.A.W. settlement included improvements for existing pensioners, and there may be a number of cases in which existing pensioners under the salaried employees' plans will not be as well off as those under the union plan.

MR. FRANCIS G. MOREWOOD: Group life coverages under the 1964 Auto Agreements depend on the age of the employee's wife and the age of his youngest child. We must either obtain detailed administrative data from the policyholder for calculating the cost of these benefits or make broad assumptions as to the typical family composition.

Denver Regional Meeting

MR. RICHARD DASKAIS: In addition to the problems of determining rates of retirement and determining the split between benefits which will be paid as Supplemental Allowances and benefits which will be paid from the regular fund, the widow's, transition, and bridge benefits cause us to be more concerned with family composition tables and remarriage rates than we have generally been in the past. Our past experience on election of subsidized joint and survivor options may not be valid, since the greater pension will probably result in a greater percentage of eligible employees electing joint and survivor pensions. We have experienced a direct correlation between the amount of pension and the election of a joint and survivor option by male employees under plans which permit option election at or near retirement.

A procedure which we have found useful to help smaller companies prepare for pension bargaining is to perform three or four valuations, valuing benefits at three or four retirement ages. The results of these valuations and various weighted averages of the results are easily understood and may be used by the principals for negotiations.

Rates of retirement will obviously depend on the relationships between the Supplemental Allowance and the employees' wages if they continue working. If an employee eligible for early retirement is earning $700 or $750 monthly, the Supplemental Allowance is much less attractive than it is to an employee earning $550 or $600 monthly. If wage rate increases are bargained in the future, the extent of inducement of early retirement by the Supplemental Allowance will depend on the extent to which increases in the amount of Supplemental Allowance may also be bargained and, additionally, the extent to which increases in the basic pension may be bargained.

MR. DORRANCE C. BRONSON: The 1964 Auto Agreements also provide that the new Supplemental Allowance benefit will terminate if an employee enters other employment and earns $1,200 or more per year. Regarding the change in definition of disability from "permanent total" to a less strict criterion, I feel this will lead to quite significant increases in disability costs.