**TRANSACTIONS OF SOCIETY OF ACTUARIES
1965 VOL. 17 PT. 2 NO. 48**

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?

MR. BLACKBURN H. HAZLEHURST: Item 11 of the Society's Guides to Professional Conduct says that the actuary should "leave no doubt that the member is the source of the opinions or findings and to indicate clearly the personal availability of the member to provide supplemental advice and explanation." The Conference of Actuaries in Public Practice in its Code says that the actuary should not "render his actuarial opinion or transmit his finding to any third party for interpretation to his client unless such third party is another actuary."

Although the majority of employees at Alexander & Alexander work in brokerage divisions with the bulk of their income derived from commissions, we also have a consulting actuarial division receiving income from fees determined on a time and cost basis. In addition to referrals from existing clients, attorneys, and banks, we receive many sales leads through referrals from the brokerage side of the business. An actuary always visits the prospective client to discuss the problems before a commitment is made to retain our firm as a consultant. Studies prepared by the actuarial division are presented directly to the client by our actuaries without assistance or intervention by nonactuaries. Our chief actuary has made a special effort to keep all actuaries in our firm operating as a professional group without allowing their consulting work to be interfered with by nonprofessional personnel. It has worked very well.

MR. PAUL R. HUDEK: All our business is on a referral basis, so we are careful to maintain contacts with trust companies, attorneys, CPA's and other professional groups. We find it necessary to work very closely with other professionals on a case that involves more than one area of competence. We are careful not to cross the line into other fields. We will, for example, assist an attorney in the drafting of certain actuarial provisions and other items necessary to complete the installation of a plan but will not perform the legal services ourselves. Turning to the matter of investing in clients, we all know of instances in which an actuary will know in advance of the public of certain items which will affect the profits of the company. In anticipation of these, he could buy or sell stock. I would consider this unethical in the same way that it is considered unethical for insiders in a corporation to trade on information not generally available to the public. It would probably be a clear conflict of interest if an actuary were to evaluate an insurance company in which he owns stock. Before taking such an assignment, I think he should sell his stock so that he would not be affected by his own report. We recently changed our billing of one block of cases we had acquired through a merger from a fee basis to time plus expenses. We do not accept commissions. Although we had anticipated objections from some of our clients who had been requesting and had received many extra services without additional charge while on the fee basis, the actual change-over went quite smoothly. Surprisingly enough, two clients preferred to stay on the fixed fee basis even though their cost would have been about 10–20 per cent less on the time basis. They preferred a fixed item for budgeting purposes.

MR. CHARLES V. SCHALLER-KELLY: In my work for the United Automobile Workers, I find I sometimes come across information not available to the general public concerning firms which bargain with the U.A.W. Although such companies are not really my clients or the clients of my employer, I wonder whether any of you would feel that trading in the stock of such a company on the basis of this information would constitute a conflict of interest and a violation of ethical standards, assuming, at least, that the value of the stock is not directly influenced by my actuarial advice.

MR. WAID J. DAVIDSON, JR.: Wouldn't anyone be in the same position if he were an actuary or not, with regard to how much he would profit from inside information?

MR. THOMAS K. PENNINGTON: A consultant is in a slightly different position from an actuary for the U.A.W. Frequently, we know inside information which is not relative to the pension plan per se. Around the end of the fiscal year the actuary has a good idea as to whether the client plans to make a maximum or a minimum pension contribution, which indicates clearly whether he has had a good year. I do not see how an actuary can invest in a client's stock on the basis of such information gained from professional practice.

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 the 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? Is there a need for such standards?

MR. JOHN L. PETERSON: We at Nelson and Warren, Inc., do not, as a regular routine, supply our life insurance company clients with a value of their stock. We do inform the company management, when we establish premium rates, as to the discounted value of profits for business produced on a given set of assumptions of mortality, interest, lapse rates, 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 as to whether the company is operating within these assumptions. As any consulting actuary knows, the first quarter of the year is a hectic one so that these investigations are by no means complete. However, it should be possible to spot any significant deviations. Such items are brought to the attention of management. If they are not sufficiently noted by management, or if the deviations are great, a detailed written report is prepared.

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 that this is the only way of knowing whether the expected profit margins established are being generated.

The variations from one company to another with regard to the type of business written make one "standard of measurement" virtually impossible. Perhaps a "standard of procedures" for valuation rather than a "standard of measurement" would be more appropriate. While differing standards for each company may seem to be a contradiction, anything else could be quite misleading. If actuaries followed standards of procedures, a very accurate valuation tailored to a particular company could be made over a period of years. There is no doubt that there is much confusion on this subject, and both stockholders and regulating officials need to be better informed. The stockholder or prospective stockholder focuses his attention on the stock as an investment so that the discounted value of profits on business now on the books may not be as important as the outlook for the future of the company. Regulatory officials, on the other hand, should be more interested in solvency and full disclosure, first for existing policyholders and stockholders and then for prospective policyholders and stockholders.

MR. WAID J. DAVIDSON, JR.: The value of a life insurance company stock is the present value of its future earnings. The peculiarities of insurance accounting make these earnings difficult to obtain. The rise in the insurance stock market in the last five years may be due primarily to an increase in the price earnings ratio rather than in the underlying increase in the earnings of the life insurance companies. Perhaps the interest in life insurance stocks will decline unless the price earnings ratio becomes a very large number. We at Bowles & Tillinghast, Inc., do not attempt to evaluate on a routine basis the stock of our client companies—although we have done it on a special basis. It is very time-consuming and relatively expensive to do a thorough, meaningful job. I have noticed, however, that owners of new life insurance companies frequently have little idea of the profit potential of the rates recommended by the actuary. This relationship of future profits to prices would be considered vital in any other business. I think the actuary is obligated to explain life insurance profit margins, no matter how complicated it seems to be.

MR. JAMES M. WOOLERY: The last part of this question refers to standards of measurement to be developed by actuaries for the use of regulatory officials. I wonder whether the insurance departments should have any interest in what profits the life insurance companies are making and what their stock is worth, provided the management seems to be capable. The SEC, on the other hand, might possibly have some interest in such a matter.

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?

MR. PAUL R. HUDEK: In the Guides to Professional Conduct it is stated that the actuary should provide an unqualified report only after he has satisfied himself that the assumptions (including the investment return) are appropriate.

As a practical matter, the initial valuation basis of a pension plan is accepted by the client as recommended by the actuary. Later on, if the basis is changed, the client will become more interested in the effect of different interest rates. Larger clients are often more interested than are smaller ones.

Considering Part C, our firm has developed an approach to asset valuation which takes into account the earnings on stocks rather than dividends only. It produces results intermediate between the cost and the market.

We feel that some shift from the cost basis will become necessary in most cases. If it isn't done voluntarily, it will likely come as a result of governmental regulation.

MR. FORREST S. OCKELS: The choice of the interest assumption is basically the function of the actuary. Occasionally a client will insist on the use of an interest rate outside the range of what we regard as reasonable. In such cases we use the selected rate, with the clear understanding that we do not recommend it.

The actuary should be active in reviewing investment performance and recommending ways in which performance may improve.

MR. JOHN L. PETERSON: We have just started using a formula method for valuation of equities between cost and market value. This is currently being applied to one plan.

MR. CHARLES V. SCHALLER-KELLY: A standard comparison of investment performance would be helpful in appraising the job done by trustees of different United Auto Workers pension plans. This tool would be effective in upgrading the results of some plans.

MR. A. CHARLES HOWELL: It certainly is a matter of considerable interest to insurance companies in the pension market in trying to determine who achieves the best kind of investment performance. We have been trying to develop some techniques for establishing a standard of performance, and, admittedly, it's very difficult.

Trustees treat, and quite properly so, the results of their own individual investment performance on an individual trust as confidential information. But from an insurance point of view, what we try to do is this. We say to an employer who has a noninsured plan: "Give us the amounts of money that you have put into your uninsured plan over its history, and we will make an analysis and tell you what we would have credited in our experience rating formula if you had put the money in an insurance company."

I think that might be a way in which we can gradually gather some of the kind of information the previous speaker was discussing.

MR. CLAUDE S. BRAVMANN: Insurance industry yields might be used as a base from which to compare investment performance of pension plans.

MR. JAY C. RIPPS: In comparing any insurance company investment results with those achieved by a trusteed plan, we must deal separately with equity and fixed income investments. In most cases, the equity investments present a far greater problem. We have been experimenting with criteria based on methods similar to those indicated by Mr. Howell; that is, using the amounts of money actually paid into the fund, we compute what would have happened had the money been invested at some standard index, such as Standard and Poor's, and then show our own investment results by comparing our Separate Account performance with the same index.

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?

MR. HOWARD YOUNG: This discussion is concerned with the problems of arriving at the estimates used in preparation for, and during, negotiation of the collective-bargaining agreements. Such estimates are necessarily less refined than subsequent calculations which can be made in a more leisurely fashion with knowledge of all details of the entire program of benefits and of the experience which develops. As of now, few of these "second looks" have been taken at the costs; it will be very interesting to see how they compare with the original estimates.

The major problems which arose were in those areas in which new benefits were negotiated, or where the benefit structure was revised to such an extent that the selection of optional decisions was probably affected.

Thus the introduction of survivor benefits payable in monthly installments to specified categories of beneficiaries was difficult to price due to lack of data on the existence of eligible beneficiaries. This is particularly true for the "Bridge" benefit, where payment is conditioned upon the age of the spouse and of any children—facts which are generally not readily available. The eligibility for this benefit also varies to some extent by sex, a factor normally not taken account of in pricing group life insurance.

The provision of some of a survivor's benefits through the group insurance program and some through the pension plan emphasized the need to recognize the interrelationships of the benefit program. Because it is frequently difficult for an actuary or other technical consultant to be present at all negotiating sessions, he may be requested to assign costs to specific benefit items so that the parties can have flexibility in framing a program. However, assigning such values is often misleading, since the utilization of benefit A may depend upon whether or not benefit B is available.

For example, the payments to disability retirees under the pension plan will be reduced by the extension of the maximum duration of weekly indemnity payments; the amount of savings is dependent upon the maximum duration agreed to and upon the level of disability pensions—items which could be varied independently by the negotiators. Similarly, it is quite likely that different retirement patterns—and costs—will occur under a plan providing benefits of $300 to $400 monthly than under one with monthly benefits of $50 to $100.

The probable utilization of early retirement was the most difficult question, since there is little experience in comparable situations. Here again, the benefit structure required separate, but interrelated, cost estimates. It was quickly discovered that retirement rates rather than average retirement ages would have to be estimated to obtain consistent results. Thus the basic pension benefits—which are reduced to an approximate actuarial equivalent in case of retirement before age 62—probably will involve costs associated with an average retirement age between 63 and 64, depending upon compulsory retirement rules. On the other hand, the early retirement supplemental allowances—which decrease slightly per year of service for retirements deferred beyond age 60 and are payable at most until age 65—will probably involve costs associated with an average retirement age between 62 and 63.

Special problems were encountered in the Canadian negotiations where the legal requirements for funding pensions are more stringent and where the benefits are partially integrated with a government program that was still in the process of development. Here in particular, future estimates can now be made on a more reliable basis than was possible during negotiations.

Some areas of the collective-bargaining agreement are open to actuarial analysis, although they are outside the programs on which we are normally consulted. An obvious example of this is paid time off for immediate family funeral attendance; this "bereavement pay" is a new feature of the 1964 auto contracts.

Finally, there was need to spend time on an area that had been somewhat neglected. Most bargaining estimates ultimately are evaluated on a cents-per-hour or per cent-of-payroll basis. The hours or payroll base on which this conversion is done is an assumption which many actuaries decline to evaluate, merely using some figure supplied by the parties. As a practical matter, however, the variation in estimates resulting from different assumptions as to this base will frequently be greater than that due to differences concerning other assumptions. A specific aspect of this question is an evaluation of the rules governing eligibility for coverage and accrual of benefits. Variations in the rules for different coverages may make it appropriate to use different hours or payroll base for the cost conversion. While future employment levels are difficult to project, the actuary should at least add his competence to that of other statistical analysts.

MR. KEATH P. GIBSON: I have observed one plan which has generous early retirement provisions. Fully 50 per cent of those eligible retired on the first day eligible. Most of the occupations are clerical.