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REPORT ON SOCIETY OF ACTUARIE ʔUST REVIEW

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The Society of Actuaries has conducted an antitrust review of its activities.

- Introduction and background. Reasons for the review. Action by Board of Governors.
- Outside counsel's review of the work of the Committee on Theory of Dividends and Other Non-Guaranteed Elements in Life Insurance and Annuities. Findings and Board action.
- Overall review of Society of Actuaries activities.
- Role of the Society of Actuaries office and General Counsel.

MR. HAROLD G. INGRAHAM, JR.: I am Senior Vice President and Chief Actuary with the New England Mutual Life Insurance Company. John O'Connor is the Society's Executive Director. Alan Lazarescu is the Society's General Counsel and an Associate General Counsel of the Metropolitan Life Insurance Company. Walter Miller is Senior Vice President and Chief Actuary of New York Life Insurance Company.

The Society's Executive Committee and Board of Governors are firmly committed to our policy of continuing to operate all Society activities in conformance with federal and state antitrust laws.

Recently the U.S. Supreme Court (i.e., American Society of Mechanical Engineers v. Hydrolevel Corporation and Goldfarb v. Virginia State Bar) has come down hard on the side of strong antitrust enforcement as it applies to professional societies. These cases involve price fixing and standards set by professional organizations and their committees.

The Society's Executive Committee, at its July 30, 1982 meeting, considered the following proposal:

- That outside counsel be retained by the Society to conduct an antitrust review and audit of its activities;
- That Sidney S. Rosdeitcher of the Paul, Weiss, Rifkind, Wharton & Garrison firm (a firm, based in New York City, which has had wide experience in the antitrust area) conduct the review; and

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- That any antitrust review of the Society's activities should be discussed with the other actuarial organizations at the next Council of Presidents meeting.

The major thrust of this review and audit was intended to provide the Society with reasonable assurance that its future efforts to provide services to the actuarial profession will continue to avoid any possible antitrust taint.

Additionally, because the Society's Committee on Theory of Dividends and Other Non-Guaranteed Elements in Life Insurance and Annuities was scheduled to discuss its progress and recommendations at the Society's 1982 Annual Meeting in October, the Society's president and treasurer also authorized a review of these efforts last summer.

Subsequently, the Board of Governors, at its October 1982 meeting, unanimously passed a resolution adopting the Executive Committee's recommendation.

At its January 1983 meeting, the Board received a progress report that the antitrust review was focusing its attention on the following four categories:

- Fairness of procedures for admission to membership and discipline of members.
- Possible anti-competitive effects of any restrictions imposed on Society members with regard to such matters as advertising, fees or methods of competition.
- Society activities that might impact competition among insurance companies, especially regarding the price or type of insurance company sponsored products.
- Procedures for insuring that opinions and projects of the Society are not used to disadvantage any group or class of employers of Society members.

The antitrust review of the Society's procedures has also been made with regard to the Supreme Court's decision in the Hydrolevel Corporation case I mentioned. That case held that a professional society could be liable for anti-competitive activities of its members, purportedly done on behalf of the professional society - even if, in fact, those activities were not authorized or ratified by the professional society.

The panel presentation of this subject will proceed as follows: Walter Miller will report on outside counsel's review and findings with respect to the work of the Committee on Theory of Dividends and Other Non-Guaranteed Elements in Life Insurance and Annuities (the so-called Garber Committee). John O'Connor will provide an overall review of Society activities and the role of the Society office in this regard. Finally, Alan Lazarescu will comment on the role of the Society's General Counsel with respect to activities that might involve antitrust issues.

MR. WALTER N. MILLER: Are any of you folks in the audience from Canada? You may be wondering what all the fuss and hullabaloo is about antitrust concerns. Stated very simply, there is an almost night and day difference between the body of antitrust law and regulation that exists in Canada (and

it does exist in Canada, but it is not generally judged to be particularly onerous or worrisome) and that which exists in the U.S., as you will hear in some more detail in this session. There is much emphasis on antitrust. There is much force behind the body of law and regulation that exists on our side of the border. There have been some very, very onerous decisions in the antitrust area which might make you wonder, "How did they ever decide that doing that was an antitrust problem?" But they have, and it is. Essentially that is why we are here because, although the Society of Actuaries is a multinational organization, many of its activities are concentrated in the U.S. and we are domiciled in the U.S.

Here is a quick bit of background on the Garber Committee's activities. The Garber Committee is the current outgrowth of what started in around 1977 as the Society's Committee on Dividend Philosophy. The committee several years ago completed a major phase of its activities when it came out with recommendations as to what should be proper or generally accepted actuarial principles in connection with the development of dividend scales for traditional par policies offered by mutual companies. This, of course, is a large area in both the U.S. and Canada but not the only area where you see insurance or annuity coverages with pricing not fully guaranteed.

The committee's recommendations with respect to the traditional par mutual company area were accepted within the Society after an exposure and discussion period, and then picked up by the American Academy of Actuaries and translated into a body of accepted actuarial practice at the Academy level. That is now going still farther forward. Proposals have been made to the National Association of Insurance Commissioners to embody some of this into annual statement disclosure of dividend practices.

It was then realized that traditional par policies offered by mutual companies are not the only consideration in this area. So the committee was asked to continue and make recommendations with respect to the two main remaining areas:

1. Participating business issued by stock companies, which at least for a number of companies has in the past operated under principles quite different from the par business offered by mutual companies.

Secondly, and certainly more important now and looking ahead:

2. The whole other broadening area of insurance and annuity policies with non-guaranteed pricing elements that are other than traditional par. Here, for example, you are talking about indeterminate premium policies, Universal Life, the so-called current value life approach, annuities with an interest rate subject to a minimum guarantee but otherwise as declared by the company from time to time, and so on.

This is essentially where all the action is today in the product field.

Last summer this committee came out with several additional sets of recommendations as to principles and practices which should apply in each of those two areas. The Board of Governors approved their publication as an exposure draft for discussion within the Society and there was considerable

discussion, both in terms of direct communication with the committee or its members and in a session that was held at the Annual Meeting of the Society last fall. That question is still open. Enough comment was received to make it obvious that changes, some of them substantive, should be made from the original exposure draft. That work is still going forward.

Shortly after the exposure draft was published last summer, it was felt that it would be very appropriate to have this process looked at specifically by the lawyers as a part of the Society's antitrust review.

The result of their work was a 46-page letter written to us by the law firm giving their specific findings and discussing why and how they arrived at them in their study of these drafts. As I go on to summarize this piece of the antitrust audit, I will be quoting some of the pertinent language in that letter.

I will begin with their conclusion, which is one that in effect says it is favorable, but. . . . This, in a way, is our introduction to the fact that in U.S. antitrust law and regulation nothing seems to be simple.

What they said pretty much up front in the letter is:

> "Based on the facts you have provided to us, and for the reasons set forth below, it is our opinion that the Recommendations do not raise substantial risks under the federal antitrust laws. Nevertheless, we caution you that the Recommendations fall within a difficult area of antitrust law in which the rules are by no means clear or well established. Accordingly, we believe it is desirable to make certain amendments to the Recommendations and the Committee's accompanying report. . . ."

I move now to a piece which is one of the two underlying themes that channeled and shaped the lawyers' opinion and are the themes that we have to be very well aware of if we are going to conduct the Society's activities on a basis where we think we have a maximum chance of escaping any antitrust problems.

The first of these two underlying themes is the fact that actuaries are professionals and the Society of Actuaries is a professional organization. In part, this letter says the Guides and Recommendations promulgated are predicated on the principle that an actuary is a professional subject to professional responsibilities to policyowners, the profession, and his client or employer and that an actuary should not compromise his professional integrity by assisting or participating in any practice that might deceive or result in the unfair treatment of policyholders.

The second theme: First, we are professionals; second, what we are trying to do is to keep the man in the street, the policyowner, from being deceived or taken advantage of. That is returned to often in this document when they discuss some of the gray areas that exist.

Another theme expressed is this:

> "Regulators and consumer advocates have expressed concern that insurers may arbitrarily increase charges or reduce benefits

under such policies and contracts."

Here they are talking about the new breed of coverages with non-guaranteed benefits or pricing.

> "The concern is that insurers may mislead consumers by declaring an initial premium or interest rate in order to sell its policies and then reduce the rate afterwards despite no underlying change in experience."

That is a way of saying that some people are worried about "bait and switch" tactics.

> "In order to prevent such deception and ensure fair and equitable treatment of policyholders, the Committee has recently drafted a set of Recommendations. . . ."

There is one more underlying theme in this letter and that is that the whole thrust of the Recommendations, not only these but the original ones on the par business offered by mutual companies, was that there was never an attempt to build a large fence and say, "Thou shalt not do anything that lies outside of the fence," that it is wrong to do things outside the fence and correct only to do things inside the fence. Rather, the whole thrust of these Recommendations, instead of building a high fence, is to walk around and draw a circle in the ground with your toe, and look at your practices and to say merely, "If you are doing anything that lies outside the circle, you have an obligation to disclose the fact that you are doing it. It is not necessarily wrong, but worthy of disclosure." That is important because that turns out to be a big part of the lawyers' reasoning that we are not engaging in price fixing. We are not saying to people, "You can't do this." What we are saying is that if you do some of these things you should make some disclosure.

The basic issues were three:

> "1. Are the Recommendations exempt from antitrust scrutiny by virtue of the McCarran-Ferguson Act?"

The McCarran-Ferguson Act provides that antitrust laws do not apply at all to the business of insurance to the extent that it is regulated by the states unless the business entails "boycott, coercion, or intimidation." If it can be successfully found or held that the McCarran Act applies, then that is all-embracing and there are no antitrust considerations. In this case, things are not that black or white and they did not quite find that so clearly.

> "2. Inasmuch as the Recommendations seek to place certain limitations on the pricing and price advertising of insurance [dividend illustrations], are the Recommendations tantamount to an agreement to fix prices, and hence a per se violation of Section 1 of the Sherman Act?"

The Sherman Act is one of the basic controlling pieces of antitrust law long standing in the U.S.

> "3. If the Recommendations do not constitute price fixing, do

> they nevertheless constitute an agreement to unreasonably restrain trade in violation of Section 1?"

On the McCarran Act, they said this is a troublesome question because you wonder whether activity like this on the part of the Society of Actuaries can legitimately be said to be "regulated by the states." In the past in some similar cases it has been a fairly easy conclusion to come to that you are all right on that because essentially you are dealing with activities relating to an insurance business that is controlled and very tightly regulated (in at least some cases) by the states. But they point out that there has been a recent Supreme Court decision which considerably narrowed that. That decision held that the only state laws covered in this connection would be laws concerning rate making, which are not quite broad enough.

The conclusion of our lawyers on the McCarran issue was that they cannot advise us to rely totally on being able to claim exemption under the McCarran-Ferguson Act. Hence we have to look further.

Here is another quote which expresses their concern:

> "Our chief concern in reviewing the proposed Recommendations is that, on their face, they plainly relate to the pricing of insurance products [not true]. If the standards espoused in the Recommendations are followed, the freedom of insurance companies to price their insurance products or to advertise the prices of such products may be limited to some extent. [As a practical matter, that is probably true.] Moreover, it might be argued that when actuaries or insurance companies limit themselves by undertaking not to make changes in charges or benefits unless justified by experience or not to seek to recoup past losses in redetermining charges and benefits, that limitation on their freedom may impose an additional cost. . . .
>
> That the Recommendations are addressed to and promulgated by actuaries, as opposed to insurance companies, does not by itself remove our concern. Since virtually all the Fellows of the Society are employed or retained by insurance companies [That, of course, is not an accurate statement, but our lawyers' antitrust review being at this point so largely limited to these dividend recommendations almost all the exposure they had was to the portion of the Society's activities and the portion of its membership involved with these activities. So it is not hard to see why they thought the Society's membership was almost exclusively company people.], and some Fellows have significant executive responsibilities at major insurance companies, a court might view the Recommendations as an agreement among insurance companies effected through their employees and agents [That these Recommendations are a sham under sort of the umbrella of "professionalism," but what is really going on is that the companies are getting together to conspire and fix prices. There is some danger there.]."

How is this to be evaluated? Section One of the Sherman Act contains a

so-called Rule of Reason which is to be used in evaluating actions and activities that are not specifically prohibited in the act as being anti-trust violations per se. They set up standards for evaluation, and the Rule of Reason is the one that is used most often in the cloudy cases, as you would expect. That is why it is there in the original legislation.

Our lawyers say:

> "We have concluded that the activities involved here are so materially and qualitatively different from any of the practices heretofore treated as per se unlawful price fixing, that they would not be classified as price fixing, but would instead be evaluated under the Rule of Reason. Of perhaps greatest importance in our analysis is that the proposed Recommendations. . . do not appear to have any effect on price competition. Not only do they not involve the fixing of specific prices, they do not require any insurance company to renounce any form or method of price competition.
>
> Nothing in the Recommendations appears to affect the price initially charged to the policyholder at the point of sale. Further as we understand the Recommendations, they are not designed to inhibit the charging or offering of lower premiums or higher dividends or interest rates; they would merely discourage increases in the price to the insured, not warranted by experience."

And then they get to a point where they had some trouble. They say:

> "A more troublesome point is raised by the portion of the Recommendations which recommends that past losses not be taken into account in redetermining charges and benefits."

This was an interesting one. At the time the Recommendations were written, the committee was split very close to 50/50 as to whether this was a proper recommendation to make, and there was considerable influence in the committee's discussion, for better or for worse, stemming from the fact that the principle that you can't take account of past losses had already been embodied in some aspects of insurance legislation or regulation in the form of guidelines adopted by some states in regulating various aspects of changes in price on coverages with non-guaranteed prices or benefits.

Our lawyers go on to say:

> "This advice, if followed, may cause actuaries to resort to a more conservative approach in calculating initial risk charges."

If you know that you are not going to be allowed to pick up past losses on a repricing, maybe you are going to start off with a somewhat higher price initially because of the additional risk you are taking. You are going to have to swallow anything that comes up adverse to the initial pricing assumptions.

> "Given the division of opinion among the committee members as to the desirability of this principle, we are less confident in saying that the cost of relinquishing this option is merely

> the cost of protecting policyholders from deception or unfair treatment. However, here too we are comforted by the fact that the Recommendations merely require disclosure. . . ."

What they didn't know when they wrote this report is that between then and now in the committee the 50/50 division has come close to virtual unanimity in favor of this principle. Maybe that is helpful.

But, in any event, with that caution they concluded that we would satisfactorily meet the test of this not being a price fixing adventure.

So the next test is the reasonableness test. Here they also give us a relatively clean bill of health.

However, they wanted us to stress in the wording of the report that this is an agreement among professional actuaries acting in their professional actuarial capacity with their Society hats on and not an agreement among companies.

With that for background, they made some specific suggestions. First, they asked us to review the Recommendation that in general a repricing should not involve any picking up of past losses. That is one that is going to be much harder for us to do now than it was when they wrote the report originally because of the growing opinion within the committee, and within the Society's membership, that this is probably a good principle to have in a set of recommendations of this nature.

Then they had a specific rewording to suggest which is interesting. This is Recommendation 23 which appears toward the end. It is "motherhoody" in a way, but important to state. It relates to language that was originally recommended by Jack Moorhead. Recommendation 23 states:

> "The actuary's primary professional responsibility with respect to illustrated dividends is to ensure that these appropriately reflect current financial results of the company and are related to paid dividends in an equitable, justifiable manner. The responsibility must be adequately discharged despite the actuary's recognition of the important role that illustrated dividends play in product cost comparisons and competition in the marketplace."

Now here is what our legal advisors had to say about that:

> "The first sentence in Recommendation 23 contains the Committee's basic standard with respect to illustrated dividends. We understand its purpose to be to prevent deception of consumers. However, as drafted, it may be read as prohibiting a stock company from illustrating dividends higher than paid dividends even if it honestly intends to increase dividends in the future. . . ."

That is quite a stretch! But the fact that it comes from a highly reputable, highly knowledgeable set of lawyers experienced in antitrust indicates the extreme nervousness that one can and perhaps has to get into when dealing with this issue.

> "In order to make this clear. . . . We suggest something like the following:
>
> > 'The actuary's primary professional responsibility with regard to illustrated dividends is to ensure that dividends reflect the current financial results of the Company and are related to paid dividends in an equitable, justifiable manner so as to prevent deception of prospective policyholders.'"

Say it, say it over, and say it over again. All we are trying to do is to prevent the poor man on the street from being deceived.

They also said that the sentence which got cut out - "The responsibility must be adequately discharged despite the actuary's recognition of the important role illustrated dividends play in product cost comparisons and competition in the marketplace" - might be read to suggest that the Recommendation may somehow restrict competition. Their suggestion was to take it out.

The next specific recommendation they had was to revise the so-called Continuity Principle in the Recommendations. This was the principle which said that you should be able to demonstrate that any changes in price are related to experience. They said we should consider revising that to have it apply to worsenings in price only (increases in premium in an indeterminate premium policy, increases in term rates in Universal Life, lowering of interest rates, and so on), just have this apply to situations where the policyowner is going to be worse off after the action. That is where you ought to say that this should be related to and presumably justifiable by experience. The lawyers' view was that there is no need to have this apply to situations where you are reducing the premium, where the situation is getting better, and there may possibly be even a little danger in doing so.

This is not a good suggestion because it is possible for a policyowner to be harmed in the other direction also by virtue of price improvements not being as great as those which could or should be made, and it would back us away from an area where there should be a presence as far as actuarial principles are concerned.

They had one more recommendation which is in the nature of motherhood, but necessary. They want added a paragraph beginning, "Actuaries, as members of a profession, have a professional responsibility. . . ." Say it, say it again, make it clear.

There were some remaining specific recommendations which I would classify in the nature of fine tuning.

Thus we have traveled through this 46-page letter, which I hope is of some interest and which is of considerable relevance, not only in terms of providing some good guidance on an important issue, but perhaps shedding some further light on specifics on the kind of situation that exists under U.S. antitrust law and regulation where it just might not be enough to say blithely, "Well, of course we are acting as professionals. We can do almost anything that seems reasonable with impunity, without worrying about some of these issues."

MR. INGRAHAM: Before we go on, Mr. Lazarescu would like to comment on Mr. Miller's remarks and also on the outside counsel's report on the Garber Committee's work.

MR. ALAN E. LAZARESCU: Mr. Miller did an excellent job, but there were a few misunderstandings of what was in this draft opinion. Mr. Miller gathered that the Rule of Reason is really set forth in the antitrust laws. It is not. There is no Rule of Reason in the antitrust laws. There is no per se violation in the antitrust laws. This is basically court-made law as established by the United States Supreme Court. The Court said, "Certain things may appear to be violations of the antitrust law, but if you can justify them and it is reasonable they may be all right. But of other categories, such as price fixing, the Court said, "This in our opinion can never be justified. So, if you show us a price fixing arrangement, there is a per se violation of the law."

Some of the recommendations will be changed in some minor respects. As I said, this was only a draft opinion letter. It is being fine tuned. It was done rather quickly because we were under a gun. We had about six or seven weeks to get it out.

The opinion is an excellent opinion. Mr. Miller gave you a very fine summary of what is in there. At this point we would answer any questions you may have with regard to the opinion or anything Mr. Miller has said. There are no questions, so we will go on to Mr. O'Connor.

MR. JOHN E. O'CONNOR, JR.: We realized that the attendance would be small at a session like this, but the Board felt it was a subject that was really important to the Society. We will be open to any questions the members may have.

I will try to bring us up to date on exactly what the antitrust laws are and how they affect a professional association, what recent developments there have been in the antitrust laws as they affect professional societies, and what the Society of Actuaries has been doing to cope with our responsibilities in this area.

Antitrust is a word that raises the eyebrows of many business people. If you are a product of a business school, you probably heard the term in college, or, depending upon your role in your company, you may have been exposed to it in your work. You are probably aware of the recent government action against the President of American Airlines concerning a telephone conversation with the President of Braniff Airlines.

What are antitrust laws and how do they affect professional societies like the Society of Actuaries? Let's start with a definition of antitrust.

Antitrust is defined as "laws to protect trade and commerce from unlawful restraints and monopolies or unfair business practices." Antitrust laws are designed to protect the principle of business competition -- the heart of American business practices since this country's beginning.

The major antitrust statutes affecting professional societies are Section 1 of the Sherman Act of 1890 and Section 5 of the Federal Trade Commission Act of 1914. Because these laws deal with issues which are fundamental to the underlying principles of the U.S. business environment, penalties for

violation are severe. Convictions can result in substantial fines and prison sentences. Conspiring to fix prices, for example, is a felony and carries a maximum prison term of three years and a maximum fine of $100,000 for individuals and $1,000,000 for corporations.

Why is the Society of Actuaries concerned about this? We do not fix prices or restrain trade, and we certainly do not condone such actions on the part of others. The reason is that professional societies, like ours, are subject to antitrust laws. A recent Supreme Court ruling against one such association has made this all the more evident.

Your Board of Governors recognizes their vested responsibility to take all reasonable action to insure continued conformance with antitrust regulations. Professional societies, such as ours, do have serious exposure to these laws and we are here to discuss what we are doing to recognize our responsibilities.

The fundamental purpose of antitrust laws is to assure equal opportunity among business competitors; that is, the laws are designed to encourage competition rather than to restrain competition.

The Sherman Act, one of the laws referred to earlier, states that, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal," and that, "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be declared guilty of a felony."

For professional societies like ours, most cases of antitrust violations have been brought under Section 1 of the Sherman Act. There are three main elements of a violation under this section:

1. There must be a conspiracy of two or more parties, i.e., code of ethics, by-laws, etc.

2. The conspiracy must cross state lines.

3. It must be unreasonable or "contrary to the public good."

With respect to antitrust laws, certain practices are considered per se violations. Per se violations are practices presumed to be inherently wrong regardless of the motivating factors. So, if you are accused of price fixing, it really doesn't make any difference if you can build a case to prove that you were lowering prices, that you were doing something for the good of the public. The mere fact that you were price fixing is a per se violation and it is considered a felony. Also included as per se violations are agreements to divide markets, to allocate production, or to impose boycotts.

There are two major exemptions under which the professional societies can avoid prosecution.

- The first is the so-called "learned professions exemption." This means that certain activities of learned professional societies are not considered "trade" or "commerce" as intended

by the antitrust laws. For example, medical and legal services may not be considered technically "trade" or "commerce" under antitrust laws.

- The second exemption is the "state action exemptions" whereby the action of a state might require a professional society to take some action which restrains trade.

A landmark case involving professional societies with antitrust laws is that of Goldfarb v. Virginia State Bar. In this case, Mr. Goldfarb, who was in the process of buying a house, could not find a lawyer to examine the title for less than the minimum fee prescribed in a schedule published by the Fairfax County Bar Association and enforced by the Virginia Bar Association. He therefore brought a class action suit against both associations for antitrust violations. The Fairfax County Bar Association claimed immunity under the doctrine of a "learned profession." The Court of Appeals ruled in its favor, but in 1975 the Supreme Court overturned that ruling and ruled against an automatic exemption from the antitrust laws on the basis of the "learned profession" theory. The court ruled that "the nature of an occupation, standing alone, does not provide sanctuary from the Sherman Act."

In general, a professional society's action violates the antitrust law if:

- The action is commercial in nature.
- It is not essential to the pursuit of the profession's legitimate goals.
- It restrains trade outside the profession's group.

Antitrust laws are enforced in three major ways:

1. The Justice Department
2. The Federal Trade Commission
3. Private Parties (suits)

Usually private party allegations would be referred by the United States Attorney to either the Justice Department or the Federal Trade Commission.

Why do professional societies present special antitrust problems? While it is obvious that exposure to antitrust problems varies from profession to profession, most professional societies deal with sensitive areas from an antitrust viewpoint, i.e., statistical information, standards, certification, etc.

In these areas, then, a guiding principle for professional societies is to avoid any agreement which restricts the members' freedom to make independent decisions in matters affecting competition.

Pricing is a fundamental concern of the antitrust laws. Price fixing is illegal per se. It is considered a violation of the antitrust laws regardless of the motivating factor. Therefore the fact that prices fixed are fair or reasonable is not a factor in antitrust laws.

One program area unique to professional societies is meetings. Meetings are intended to provide a forum for appropriate education and learned exchanges, but if they are not properly structured, antitrust problems can occur. For example, at Society of Actuaries meetings the moderators and workshop chairmen must have all material to be distributed and discussed at their sessions reviewed and approved by the Society's legal counsel before the meeting. The Society is now instituting a program whereby all workshop chairmen and moderators are informed that, should inappropriate pricing discussions occur in their sessions, they are to interrupt such discussions and provide a warning concerning possible antitrust exposures. If the discussion continues after such a warning has been issued, the Society's policy is to terminate the session.

The likelihood of a professional society being prosecuted for discussions with antitrust implications at its meetings depends upon to what extent that society promoted or condoned the discussions. Guarding against these dangerous discussions at Society meetings places a great deal of responsibility on myself, the Program Committee, our Board of Governors and our General Counsel.

Because pricing discussions by members of a professional society are particularly dangerous, it is important to understand the extent to which the Society of Actuaries itself can gather and distribute price information. Guidelines for this area indicate that a professional society can safely distribute such information if it is reporting prior transactions and dealing with composite information. Additionally, a key factor is that this information must be made available to all, members and non-members alike.

Another area that we must continue to examine for antitrust violations is membership status. Generally speaking, people join professional societies to enhance their professional knowledge and stature through affiliation with their peers. If a professional society denies membership, it can be interpreted as impairing a person's ability to compete. Don't misunderstand me. It is not wrong to deny membership; however, membership criteria must be reasonable, consistent and clearly defined.

As we indicated before, it is essential and in conformance with antitrust regulations that professional societies make available programs and services to non-members as well as members. Reasonable price differentials are acceptable, but the services must be made available.

A common function of professional societies is to report on various statistics or costs of the industry they serve. In general, reporting these costs and statistics does not violate antitrust laws if their purpose is clearly spelled out, if they are voluntary, and if they deal only with prior transactions. These studies must also be made available to the general public.

Up to now we have talked about antitrust laws in general and their overall applicability to professional societies. Now let's talk about a specific case that hit the association field like a lightning bolt within the past year. This case is referred to as the Hydrolevel Decision. In May of 1982, the United States Supreme Court reminded us through this Hydrolevel case of the exposure we as a professional society have to Federal antitrust laws. This case involved a ruling against the American Society of Mechanical Engineers, Inc. (ASME).

The American Society of Mechanical Engineers, Inc. is a nonprofit membership corporation with a structure similar to the Society of Actuaries. For many years it has been active in developing voluntary codes and standards. One set of standards they developed dealt with boiler and pressure vessels, including a device which is designed to block the flow of fuel to a boiler when the boiler falls to a critical level. For several years one manufacturer, McDonnell & Miller, Inc. (M&M), has enjoyed a dominant share of the market for this device.

A company called Hydrolevel Corporation entered this particular segment of the market with a new device that provided serious competition to the McDonnell & Miller product. Conforming with its past practice, ASME's Board of Governors delegated the review of this new product to its Boiler and Pressure Committee. This committee could in turn refer the review to a subcommittee. A Vice President for M&M also happened to be the Vice Chairman of the subcommittee which sets the standards for this particular product. This individual, along with other officials of the M&M corporation conspired to damage the reputation of the new product during a meeting with the Chairman of the subcommittee. Their plan called for developing a letter of inquiry to be sent by another M&M corporation official to the subcommittee. The letter asked if the new product would satisfy the subcommittee's code requirements. It was drafted in a way they believed would elicit a negative response. After the ASME received this letter, in conformance with existing procedures, it was referred to the subcommittee, the Chairman of which was part of the conspiracy. ASME knew nothing of the conspiracy and was following standard procedures for these types of inquiries. An "unofficial" communication critical of the new product was drafted and sent to the McDonnell & Miller Corporation on ASME letterhead and over the signature of the ASME's Secretary.

What happened next was that M&M sales people used this critical letter from ASME to gain a competitive edge in the marketplace. When the Hydrolevel Corporation found out about the letter, they demanded that ASME cure its effect. Ultimately the full ASMA standards committee issued a new letter indicating the acceptability of the new product. The conspiracy between the two committee persons did not become knowledge until several years later.

The Hydrolevel Corporation brought antitrust suits against the manufacturer of the other product (M&M) and received an $800,000 out of court settlement.

Although the conspiracy occurred without the knowledge of the "official" ASME structure, Hydrolevel Corporation also brought an antitrust suit against the association. The courts ruled against the ASME and awarded $3,300,000 in damages to the Hydrolevel Corporation in accordance with Federal antitrust statutes.

One of the major underlying principles of this suit was that ASME's committee members acted within their apparent authority when they participated in the conspiracy.

The major theme running throughout the majority opinion of the courts is that it is neither inequitable nor unjust to hold a professional society liable since that society stands in the best position to prevent the objectionable conduct of its members.

Here you had a situation where the elected officials of the American Society of Mechanical Engineers were acting in good faith. Their system was not designed to catch situations of this nature, and as a result it was held that they should have had a system to catch situations of this nature and they had a judgment of $3,300,000 against them for it.

Obviously, this raises questions for the Society of Actuaries. It was one of the things that triggered our General Counsel to suggest an antitrust review for the Society. Some questions and issues the case raises as applied to professional societies like ours are:

1. Who may act on behalf of our Society?

   Board
   Executive Committee
   Chief staff members
   Committees
   Members/Volunteers

2. Who should be able to act for our Society?

   Board
   Executive Committee between Board meetings
   Chief Staff Executive
   Should all others have expressed authority?

3. What procedures should be established to insure that "agents" of the Society act properly?

   By-Law provisions
   Guidelines for policy statements
   Personnel manuals with job descriptions
   Due process appeals procedure for publications

The Society presently protects itself against exposure to possible antitrust violations in various ways, such as:

- All members of the Board of Governors receive a manual which is intended to delineate their authority and responsibility.
- All key staff personnel have written job descriptions covering their responsibilities and authority.
- The Society has a widely published Constitution and By-Laws -- reprinted annually in the Yearbook.
- The Society's Secretary reports on non-routine business of the Board of Governors and Executive Committee at the Society meetings.
- All members can request copies of the minutes of Board of Governors meetings.
- All committees are encouraged to publish their annual report in the Committee Reports booklet which is distributed to all members.
- The Board of Governors has established policy committees to

oversee and recommend policy for our various operating committees.

- All Society meeting contents, programs, and handouts are reviewed in advance by our Legal Counsel.

- The Program Committee continually alerts its participants to avoid sensitive areas with antitrust implications. The Academy of Actuaries' publication having to do with antitrust violations for professional societies has been distributed to members of the Program Committee.

- Our Legal Counsel attends all meetings of the Society's Committee on Complaints and Discipline.

The Society of Actuaries has been very sensitive to antitrust issues in the past and perhaps has more safeguards than many professional societies do. However, we also have recognized that the publicity in both government and industry resulting from the Hydrolevel Decision has sent shock waves throughout the association field.

Even though the Board of Governors is confident that there have been no past antitrust violations by the Society, it is committed to the prudent exercise of its vested responsibilities. Accordingly, it has arranged for an antitrust review of the Society of Actuaries by the well respected law firm of Paul, Weiss, Rifkind, Wharton & Garrison, which has several partners specializing in antitrust practice. The attorneys will review all Society activities and provide recommendations accordingly. A first draft of their report has been received. It was a very good report, which tends to give us assurance that we are doing things in the right direction.

At this point I would like to introduce Alan E. Lazarescu, the Society's Legal Counsel since 1977, who will bring you up to date on this antitrust review.

MR. INGRAHAM: Does anyone wish to comment on Mr. O'Connor's remarks?

MR. JAMES F. ALLEN: What you have reported are things that have been done to protect the Society from antitrust problems. Is there any intention to do anything to protect the members themselves?

MR. LAZARESCU: I am not in a position to advise you in your own individual capacity. I can offer advice regarding your activities pertaining to Society matters. As you know, the American Academy of Actuaries has distributed Guidelines for its members in this area, but only a few have read them. It is unfortunate that we cannot generate more interest in this area.

MR. O'CONNOR: There is a tremendous amount of naïveté in the area of antitrust law on the part of many professionals. There are people who have been burned in the area who realize how important it is. Our profession is not any different from many others. Ignorance is not any defense with respect to this particular law. It is too bad that many of the members of the Society have not been alerted to this possibility as it affects their participation in meetings on an individual basis as well. You will find that in many of the major corporations if their top people are in a situation where a discussion of pricing begins, you would see them walking out

the door very quickly. They have been alerted by their legal staff to the dangers in this area.

MR. DALE R. EGEBERG: To what extent were the Guildelines you mentioned distributed?

MR. LAZARESCU: The Society did not send them out. They were sent out by the Academy. We did distribute them to the Board of Governors, Committee Chairmen and Vice-Chairmen. We did not make a general mailing.

It is now time for me to make my presentation. I have been General Counsel of the Society of Actuaries since October of 1977. One of my principal duties as Legal Counsel is to guide and assist the Society in avoiding problems in the sometimes murky waters of antitrust laws. It should be noted that the antitrust area of the law is somewhat technical and it is possible to violate antitrust laws without intending to do so.

In this presentation I will attempt to give you a broad antitrust laws overview, in nontechnical terms, of some of the areas involving this matter. The purpose of antitrust laws is to retain and foster competition between persons (which includes corporations and associations) engaged in business matters.

On the federal level there are two antitrust laws which directly affect associations, namely, the Sherman Act and the Federal Trade Commission Act. Basically, these acts prohibit a person from making a contract (implied or formal), or engaging in any action, with another person which restrains commerce or trade (i.e., competition).

The Sherman Act is enforced by the United States Department of Justice and private persons can bring a treble damages claim under this act. (That is how the society mentioned in the Hydrolevel case got hit for $3,300,000. The actual damages in that case were $1,100,000.) The Federal Trade Commission Act is enforced by the Federal Trade Commission. There is no private cause of action under this act. The Federal Trade Commission has very broad powers in defining what are "unfair methods of competition." If they find something is an unfair method of competition, they can institute enforcement procedures. The penalties for an antitrust laws violation can be civil (money damages) and criminal (fine and/or jail term).

Most states have their own antitrust laws. However, for purposes of this presentation it suffices to say that compliance with federal antitrust laws will generally constitute compliance with state antitrust laws.

I am sure that many of you are familiar with the McCarran-Ferguson Act.[1] Basically, this act provides that the federal antitrust laws do not apply (except for acts of "boycott, coercion or intimidation") to the "business of insurance" to the extent such business is regulated by the states. The key words are "business of insurance" and "to the extent such business is regulated by the states." Even if you are in the business of insurance, if the states do not regulate a particular area, you do not have any McCarran-Ferguson Act protection.

What does McCarran-Ferguson do? McCarran-Ferguson in a strict sense is the

1. 15 U.S.C., Sections 1011-1015.

first line of defense for someone engaged in the insurance business. If someone were not engaged in the business of insurance, what they may or may not have done may be an antitrust law violation. If you are engaged in the insurance business, the first line of defense is generally the McCarran-Ferguson Act. If a person engaged in the insurance business loses that ground, it does not mean that they have lost the case. It just means that they have lost their first defense. Now the plaintiff has to prove that there has been an actual antitrust laws violation.

Recent United States Supreme Court decisions have substantially narrowed the definition of the "business of insurance." It is highly questionable whether the Society would be considered to be in the "business of insurance." This being the situation, any discussion herein is based on the assumption that the exemption of McCarran-Ferguson does not apply to the Society. It is possible to set up a situation where the Society could be held liable for an antitrust laws violation while the actual people engaged in the violation, namely, insurers, would not be held liable. Why? Because of McCarran-Ferguson's provisions ("business of insurance. . . state regulation") they are not liable. But yet the Society can be held liable.

A 1975 United States Supreme Court antitrust laws decision[2] involving a bar association's minimum fee schedule for attorneys' services made it clear that the antitrust laws were applicable to professional associations. A 1982 United States Supreme Court antitrust laws case worthy of discussion is that of American Society of Mechanical Engineers v. Hydrolevel Corp.[3]

Mr. O'Connor gave you the basic facts in this case and there is no need to repeat them. However, I will mention a few additional factual matters involving the case.

The product involved in that case was pressure valves which were placed on boilers to tell you how much steam you had in the boiler. Hydrolevel came out with a new type of valve which I could equate with a time delayed fuse, with which most of you are familiar. The traditional 15 amp fuse blows as soon as you exceed 15 amps. The time delayed fuse will let you exceed 15 amps for a short duration because you have a surge and then it may come down. If it exceeds 15 amps for 10 seconds or more, you blow a time delayed fuse. Basically, the time delayed valve works the same way. Technically, the valve in question did not comply with the guidelines of the engineering association. However, it appears that it was as safe in all respects as the other standard valve. As previously mentioned, the case was a setup.

In this case the Supreme Court affirmed a treble damages claim against the defendant nonprofit professional association. The association was deemed liable for damages because a Vice Chairman (who was a volunteer and not an employee of the association) of one of the association's subcommittees was apparently a primary mover in having the parent committee render an "unofficial" position, on the association's stationery, which injured a competitor of the Vice Chairman's employer. It appears that the Vice Chairman was acting for the benefit of his employer and not for the benefit of the association.

2. Goldfarb v. Virginia State Bar, 421 U.S. 773, reh. denied, 423 U.S. 886 (1975).
3. _____U.S._____, 1982-2 (CCH) Trade Cases Par. 64, 730 (1982).

The significant feature of the case is apparent authority. The man who wrote the letter which was used for anticompetitive purposes had apparent authority to do so as far as third persons were concerned. At least to outsiders, the purchasers of these valves, this man had apparent authority to render a ruling that these valves did not meet the association's standards. Also, the standards of this association were very crucial as to whether the product did or did not comply, for their standards were also adopted by many local governments in their building codes and in their safety codes. So if you had a product that did not comply, in effect you really could not market it. The key here is apparent authority to the outside world.

The structure of the association in the Hydrolevel case is very similar to the Society of Actuaries in certain respects, namely, a relatively small staff of paid employees in relationship to the number of members and the need to rely on unpaid member volunteers to carry out many of the functions of the organization. This court decision illustrates that member volunteers can expose the Society to substantial liability when they are acting in a capacity which, to an outsider, "appears" to give them authority to take a particular action on behalf of the Society.

A prerequisite for membership in many, if not most, professional organizations is obtaining an education or degree from a school, college, or university in the professional field involved. Usually a professional organization is not involved in a person's basic preparation and training for the profession. The Society of Actuaries is unique because it provides the preparation and examination structure which qualifies a person for membership in the Society. It is clear that the Society has a basic educational as well as a membership function. In certain respects the basic educational function places a greater burden on the Society, from an antitrust laws point of view, than is placed on most other professional organizations.

Membership in the Society is a valuable asset (financial and otherwise) to most of its members. It is the membership, and recognition that flows therefrom, which has helped the member to obtain employment, and/or advancement in position, in the actuarial field. The antitrust laws protect and foster competition within a professional field. Therefore it is important that an organization such as the Society have reasonable membership admission standards and not be considered to be a "closed club" because of arbitrary admission criteria. In this regard the examination structure (which is the basic requirement for admission to the Society) must be relevant and fair in substance as well as form. The Society's examination structure does satisfy these basic standards.

As Legal Counsel of the Society, I am somewhat involved with the examination process of the Society. I become very much involved with this process when a student protests that the structure is unfair (which usually means the student did not pass an examination) or there is an allegation that a student received help while taking an examination (cheating incident). One of my main concerns in these instances is whether the student is being treated fairly. Some of these matters may involve a comprehensive investigation and possibly a hearing with the student's attorney present. At such a hearing the student's attorney may examine witnesses and examine and introduce documents, etc., into evidence.

Discipline of a member of the Society is very much of concern to me because

discipline (sanctions run from a "warning" to "expulsion" from membership) of a member can harm the person in his or her economic and other interests. The Constitution of the Society provides the formal structure for the discipline of a member. To the best of my knowledge, I review every case involving a question of alleged unprofessional conduct at or before the time a formal complaint is made. One of my concerns in this area is to make sure that the constitutional provisions of the Society have been, and are being, closely followed. Also, I am very much concerned with the question of whether the charge of misconduct is reasonable under the circumstances. If it is determined to proceed with the complaint, I must be satisfied that the charges of misconduct are precise and the person complained about is aware of every right he or she is entitled to, including the important right to be represented by counsel of his or her own choosing. One of the keys to avoiding antitrust laws liability, and other forms of liability, in this area is to make sure that the person complained about is treated in a "fair" manner. This comes down to substantive and procedural due process.

One of the many areas an actuary is concerned with is the proper "pricing" of a product. The "pricing" of a product is, in part, the subject of a student's basic education and a part of the continuing education programs of the Society. It should be noted that "price fixing" is considered to be a per se violation of the antitrust laws. This means that when price fixing is involved the courts are not interested in the reason for the price fixing arrangement. Simply stated, a price fixing arrangement violates the antitrust laws. It is one of my concerns as Legal Counsel that members, in connection with Society functions and matters, do not engage in any activity which may prove to be illegal. The members may discuss the various methods and factors to be considered in pricing a product. However, the members should not discuss, or agree to, the actual prices their employers or clients are charging, or will charge, for particular products.

As Legal Counsel, I review the programs for all Society of Actuaries functions in order to determine whether it is prudent to discuss a particular matter. I attend all meetings of the Board of Governors and the Executive Committee. On a daily basis I render advice to the officers and staff of the Society

As previously mentioned by the other persons on this program, we did have a well known law firm review from an antitrust point of view the activities of the Society. I was one of the principal proponents for such a review because I am a firm believer in a "second opinion" in an area as important as antitrust. The review confirmed my opinion that the structure and practices of the Society are basically sound. However, we must be careful that we do not become complacent and neglect to do the things that are necessary to continue to keep the Society "clean" in respect to this important area of United States law.

Needless to say, this presentation did not cover every topic which could be of concern in the antitrust laws area. I would be pleased to attempt to answer any questions you may have.

MR. EGEBERG: You stated that a member may discuss methods and factors involved in pricing, but not actual prices. Fairly commonly you will hear a reinsurer talking about factors involved in pricing, for instance, first year lapse rates on term insurance. That is an important aspect of pricing,

but it is not a price.

MR. LAZARESCU: That is not a price, and you could say, "We have a first year lapse rate of 25 per cent." Anything like that is perfectly all right to discuss. It is when you get down to specifics and the insurer starts saying, "I am going to charge X amount per thousand," and the other individual is sitting there and thinking, "He is underselling me. I am going to have to charge X amount per thousand if I am going to get the business." That is where you start getting into problems. But if you are talking about factors that go into pricing that is all right. But I would not like any discussion about specific prices.

MR. MILLER: Let me ask you this. One of the things I have been taught in my own company is that in terms of what is an antitrust laws violation, it is all right to talk about what you are doing, but it is not all right to talk about what you are planning. In those terms, let us take New York Life's premium rates for whole life policies this year at age 35. Are you saying that is something I should not talk about in a workshop or a meeting? It is certainly a matter of public record.

MR. LAZARESCU: That is the point I was going to make. There is generally not a public record when we are talking about what is the price in the reinsurance area. But in your particular area it is public record because you filed your rate books with the Insurance Department. If I want to find out what your company is charging for a 20-year endowment or a whole life policy I can do so. It is very easy. It is not a trade secret. But when you get into areas that are not generally known they should not be discussed because one could draw a conclusion from that. For instance, if you get a group of reinsurers in a room and they start talking about pricing and the next day everybody is doing the same thing, one can infer that there was some kind of agreement. It didn't have to be formal, as I mentioned, but implied that they are going to charge a certain price. So you have to be very careful. You have to know what market you are dealing in, what is available to the general public in terms of information.

MR. INGRAHAM: How do you feel about the company practice of exchanging rate manuals?

MR. LAZARESCU: It varies from company to company. A few years ago all the companies were doing it. In fact many companies just sent it to you. They didn't even ask if you wanted it. We have made it a practice not to send out our manuals any longer. The reason for this is that we simply feel that it could possibly be construed, though it is far-fetched, that if prices start looking the same there was some kind of agreement.

MR. INGRAHAM: In many instances there are tiny insurance companies with no actuaries in house and they rely very heavily on the reinsurers to price their products. In many cases they simply take the price their reinsurer's direct-writing division is using. That, I suppose, is a blatant example of price fixing, but on the other hand it is probably for the good of the consumer. Are these possibly antitrust violations?

MR. LAZARESCU: Probably not. It makes sense in a case like that. You are going to base your charges on what you are being charged for the services rendered to you. It is basically the same thing as a grocer going to a wholesaler and asking, "What are you going to charge me for Cheerios today?"

The wholesaler tells him and the grocer bases his price on what he is being charged. That is the nature of the business. There is nothing wrong with an insurance company direct writer basing his price on what he is being charged by the reinsurer. That is just common sense.

I want to add here that we have the McCarran-Ferguson Act first line of defense when dealing in the area of insurance. The Supreme Court has narrowed the definition of the "business of insurance," but so far it has not gotten into the price area in the business of insurance. At least at this time, most attorneys would probably say that pricing falls within the McCarran-Ferguson Act because there has been some regulation by the states. It doesn't have to be onerous regulation, but some sort of regulation.

MS. CATHY H. WALDHAUSER: The speaker stated that if we are discussing prices one important difference is whether or not the price we are discussing is public information or is not. Would you put information on agents' compensation contracts and that type of thing in the same category with pricing information that is not made public?

MR. LAZARESCU: I look at it from the point of view of the agents. If all the companies get together and decide to give agents a commission of 15 per cent or less on whole life insurance, you may not get an antitrust suit from the general public because you are driving prices down. They may be perfectly happy. But you may get it from the agents. I think agents' compensation is a very sensitive area.

MR. INGRAHAM: It should be pointed out that in many instances you can go to the Life Insurance Marketing and Research Association (LIMRA) and many agents' commission scales are on file publicly to the extent that you can retrieve the information. There is a common information bank there to which they can apply.

Thank you for coming. We are adjourned.