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DIVIDEND PHILOSOPHY

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Discussion of the latest Exposure Draft of the Committee on Theory of Dividends and Other Non-Guaranteed Elements in Life Insurance and Annuities and of other related developments in this area.

MR. WILLIAM T. TOZER: In the Fall of 1982, the Society Committee on Theory of Dividends and Other Non-Guaranteed Elements released two draft recommendations. These draft recommendations were exposed to the Society members and discussed at the Fall meeting of the Society. In October 1983, a revised version of these recommendations was discussed at the Society's annual meeting in Hollywood, Florida.

The Society Committee plans to present a final recommendation on dividends to the Board of Governors in the near future. The recommendation on the non- guaranteed elements is still under consideration by the Society Committee and a final recommendation to the Board of Governors will be made later on that issue.

Because the Society Committee is finalizing its work in the dividend area, the Academy Committee on Dividends and Non-Guaranteed Elements has become very active. Both of our panel members today are members of the Academy Committee. The panel members will make short presentations which we hope will stimulate comments and suggestions that will be beneficial to both the Academy and Society Committees. We also have members in the audience from the Society Committees, so your input will get consideration by both of these committees.

MR. CLAUDE THAU: The October 1983 version of Recommendation 13A dealing with Participating Insurance had changes which basically fell into three areas.

1. It applied not only to life insurance but also to annuities. That had minimal, if any, impact throughout the guidelines.

2. It applied to participating business sold by stock companies.

3. There were a number of minor technical changes for clarification.

The two changes to the guidelines that are the most interesting both came as a result of the stock company issue, although one of them in particular also affects mutual companies. That one is the suggestion in the guidelines that separation of accounts can be very helpful in establishing an appropriate dividend scale. Not only was this generated to keep the non-par account and

the par account separate in a stock company, but it also applies to various lines of business within a mutual company, for example, the group line vs. the individual line.

The second interesting change is in Section 12 of the Recommendations. It refers to transfers in a stock company from the participating account to the non-participating account and relates to the reasonableness of such transfers.

Since October 1983, some more changes have been made, but they have basically all been of a technical nature. I will briefly get into a couple of them just to give you an idea of how little deserving of discussion they really are. Section 5.2 previously said that if, in developing experience factors, you did not have sufficient statistical data, you should use your judgement. It has been modified to point out that even if there is significant statistical data, you should still use your judgement. In §13.3 there was a key section that said that the actuary should report to his or her management if continuation of current experience or an adverse change in experience might keep the current dividend scale from being maintained in the near future. This has been changed because favorable experience might have the same impact. For instance, new business strain, which could be considered to be not adverse experience but favorable experience, might actually impinge upon the continuation of a dividend scale because of cash shortages that could result. Also because of tax or other legal changes, there could be a windfall ability to distribute a lot of money via dividend scale which might not be able to be continued. So, this has just been generalized a little bit more so that regardless of why an actuary feels that the current illustrated dividend scale may not be able to be continued, he or she should report it.

The Society Committee, as I understand, is intending to bring this to the Board of Governors in May. The Academy Committee is just starting to get involved in this pretty heavily now. Another meeting is scheduled for mid-May.

There are basically five areas that the Academy Committee will be dealing with.

1. There are housekeeping changes that you have to make to change it from a Society guideline to an Academy guideline.

2. Further clarification might be considered to be advisable.

3. The Academy Committee wants to consider publishing some interpretations. As yet, no interpretations have been published. Several people, in trying to apply the guidelines, have come up with questions. Maybe we can clarify them by having interpretations; we would like input on which areas need clarification.

4. The transition rules for stock companies, in particular for so called "frozen rope" type policies, must be dealt with. That obviously promises to possibly be a "hot potato".

5. Disclosure issues, such as necessary modifications or suggested modifications to Schedule M, must be considered.

MR. RICHARD M. STENSON: I am going to talk about Recommendation 13B. The Academy Committee is beginning to consider this now. Several years ago, when we came out with our recommendations and report with respect to par policies in mutual companies, we left aside the question of par policies in stock companies that Claude has just talked about, and also the question of policies with non-guaranteed elements. At the time, I remember thinking that a mutual company's involvement was pretty much taken care of with the dividend question. That certainly has not become the case, as many such companies, including my own, are getting into Universal Life type policies directly or through a subsidiary and thus into the business of dealing with policies with non-guaranteed elements. Bill Tozer pointed out that there have been two reports of the Society's Committee. One in late 1982 covering both par policies and non-guaranteed elements, and one in October 1983 covering the same issues with revised recommendations. They have both been discussed in previous Open Forums, but we look forward to getting your comments here.

First off, "13A and 13B", where do they come from? They were the labels attached to the recommendations in the August 1982 report, but I noticed that the phrases had begun to drop from the October 1983 report. I imagine at some date in the future they will drop from the written record altogether and some of the older actuaries will sit around wisely talking about Recommendations 13A and 13B. The younger actuaries will say, "What is 13A?" I think that is good. There should be a few mysteries that older actuaries have over younger ones.

Recommendation 13B covers actuarial principles and practices in connection with individual policies and contracts containing non-guaranteed charges and/or benefits; such as Universal Life policies, indeterminate premium policies on which charges for benefits may vary at company discretion, and so-called excess interest contracts. It does not apply to elements directly following a separate account result, such as in a Variable Life policy, nor to those linked to a defined index. It does cover any non-guaranteed element other than dividends in par or nominally par contracts, as well as in non-par contracts.

I would like to briefly review the major thrust of these 13B recommendations as they currently exist in hopes that we can draw comments from you. First, as is the case with the basic 13A recommendations on dividends, a professional obligation would be placed on the actuary, by the actuary's peers, which operates through disclosure to the client of the actuary. In this case, the client is the management of the company for whom pricing recommendations are prepared.

Whether or not this limited applicability will stand long is an important part of the discussion and dialogue that so far has surrounded the development of these recommendations. As we know, in the dividend area there is now the Schedule M disclosure that is part of the public process.

The nature of the disclosure is wrapped around deviation reporting or exception reporting. Where you deviate from the principles outlined in the recommendation is what you should report to your management.

The most important principle in the 13B recommendations has a newly coined name, the Continuity Principle. This is different from the Contribution Principle of Participating Policies under which changes in effective charges or benefits to customers (i.e., the dividends) are driven by changes in

underlying experience. The Continuity Principle is driven by changes in charges or benefits to customers. If there is no change in the first place from issue in charges or benefits to customers, the Continuity Principle simply does not come in. If underlying experience improves, there is no obligation under the Principle as currently written to distribute the additional earnings to customers. Now the marketplace may tell you something else, but as far as the Principle is concerned, there is no such obligation. Should underlying experience deteriorate, there is no obligation to share that grief with the customers, although there are some other forces that might lead to a different conclusion there.

In the 1982 version of the recommendations, the Continuity Principle comes in whenever changes in benefits or charges are made, and it then requires that they be justified in terms of changes in anticipated underlying experience. The word anticipated is a very important distinction in dealing with non-guaranteed elements. The experience one uses to justify a change, once a change is made, should be anticipated future experience rather than the past experience base that forms the basis for declaring dividends in a traditional par policy. This distinction continued in the 1983 version of 13B. However, the 1983 version changed by limiting this application of the Continuity Principle in that it only comes in when non-guaranteed charges are <u>increased</u> or benefits <u>reduced</u> as compared to those illustrated at issue. Then the changes need to be based on changes in underlying anticipated experience. This is a further evolution in the Principle that I see as tracking back to the roots of non-guaranteed policies in the non-par environment. What you buy is what you see at issue.

The recommendations go on to lend further structure to the Continuity Principle and the framework of assumptions on which the actuary's advice should be based. They discuss policy class, policy factors and the various anticipated experience factors.

I would like to draw attention to two specific elements of the recommendation, both of which also had some evolution between 1982 and 1983, and both of which deserve some explicit comment. Recommendation 14 and its preamble state that for a class of business, changes after issue in charges and benefits should not involve an increase in the provision for profit and risk unless there has been a clear increase in risk for the policy class or the new profit level is brought to a level at or below that on comparable new business. In other words, the profit levels for a group of policies in general should be frozen at issue and followed into the future. Recommendation 15 and its preamble provide that a specific provision for recovery of past losses in a redetermination of non-guaranteed charges or benefits may be considered to be an element of anticipated experience for purposes of determining whether the Continuity Principle is satisfied. There may be some circumstances, even though one should be looking at anticipated future experience, where an element of something that had happened in the past may be brought in. Both a change in profit level or provision for past losses should be disclosed in the actuary's report to management.

I would now like to briefly discuss a series of very simple scenarios focusing on a Universal Life type of policy as to what I think in general these guidelines imply. Consider a non-par Universal Life policy issued by a stock company with the following characteristics.

1. Guaranteed interest rate of 4%, with the ability to declare higher rates of interest.

2. Guaranteed mortality charges based on 1958 CSO with declared lower charges.

3. Guaranteed expense loadings and surrender charges, with future changes not anticipated.

Scenario One: Anticipated experience factors remain at the level assumed at issue. The initial mortality charges and declared rates of interest could not be made less liberal for existing policyholders without violating the Continuity Principle. When I say they cannot, I mean that it would require disclosure, not that they cannot be changed. Presumably, they could be made more liberal if you did not mind making a little less money.

Scenario Two: The anticipated experience factors worsen. In this case, we have interest credits and mortality charges to work with, and they could be cut back to an appropriate level based on what we expect prospectively. Losses in the interim should not be recouped, in general.

Scenario Three: Experience improves. There is no need under the recommendations to make any changes. You might have quite a nasty replacement situation if you do not, but if you are able to keep enough business in force and realize increased profits, that is fine as far as the Continuity Principle is concerned. In a pure sense it would not require changes, as I read it, even if terms were liberalized for new policyholders. The key question here is, does the customer get what he or she expected when the contract was issued.

Scenario Four: New management or current management requests higher profits from this line of business even though anticipated experience factors have not changed. This could arise as a result of losses in other lines, for example. *This is where Recommendation 14 would allow a cutback to existing* customer, even with anticipated experience continuing to remain the same; so long as it also happens on new business, and the cutback on existing policies is to bring profit levels up to those on new business. There will be a reporting requirement to management.

Scenario Five: Experience gets better and then gets worse. To the extent the pot is sweetened for old policyholders on the improvement, you could take that away on the deterioration without, in the context of the recommendations, worrying about the Continuity Principle. You would still be at a level that would be at least as good for existing customers as illustrated at issue. Naturally, if you wanted to go below that, you should then be sure that those changes are justified by anticipated future experience.

There is a lot of impact here on how one views the role of the actuary as a professional. Here, the company management is viewed to be the customer of the actuary. How much responsibility is there as a professional to the ultimate buying public? That is something that has to be factored in. The situation will also undergo changes as the policies we are dealing with continue to evolve.

MR. TOZER: With us this morning is Harry Garber, who is Chairman of the Society Committee that is studying this issue. Harry would you please bring us up to date on the developments that the panel has not covered.

MR. HARRY D. GARBER: The Society Committee, in reviewing the comments on 13B has to question whether we should not take a hard look at it. I want to describe today what that new look would be. If any of you have strong feelings on this matter, we would appreciate hearing from you. I hope you will understand that what I am talking about is relatively immature in development, so it is really just a concept rather than a fully developed idea. It is important because it gets to the issue that Dick was talking about as to what the role of the Society is in this area.

Let me start by contrasting the participating area vs. the new products of Universal Life and Excess Interest type products. When the Committee came into being, some eight years ago, it was because of a number of concerns about a period of rapid change in the area of dividend practices. These were changes that were causing concern within the industry itself, and certainly causing concern with the regulators. Dividend practices seemed to be moving fast and departing from the traditional path.

We have an issue where actuarial business theory was well established. The Committee, in effect, bounded the problem by saying it was only going to deal with the distribution of a defined amount of dividends and with the associated illustrations. What the Committee did was to review where we were and to propose recommendations which described principles for the conduct of the business. I want to emphasize the conduct of the business because that is the key issue here. Recommendations took the form of describing the principles which were the Contribution Principle and the way that was to be put into practice. The actuary was asked then to prepare a report with respect to the dividend scale describing the extent to which anything he or she were doing would vary from the Contribution Principle and from the practices that were associated with it as per the recommendations. That is the form that 13A takes.

The Committee's area was expanded, and it was asked to look into the area of non-guaranteed benefits and charges. We had there something without accepted principles or standards. In fact, it was all very new, fast growing and changing. On the other hand, there was a good deal of regulatory agitation and action, some of it ill-founded. One of the concerns of the Committee members and of the industry is that the regulators not take actions which are going to lead to shutting down the development of the business but rather that they take actions which will permit the business to grow and thrive. The concern was that if the Committee did not take action to meet the concerns of the regulators, then the regulators would take action which would be worse than actions designed more carefully by the actuarial profession.

We started with a view that what we were really considering were the principles that should underlie the conduct of the business. The recommendations that Dick Stenson described to you were based on this premise. We have received a fair amount of criticism on this; although I have to say it is not a lot, it has been quite vocal. Some of it I would describe as shrill. A lot of it, though, is thoughtful and concerned. The latter comments were saying that you have a new and evolving business, and that principles should emerge from operations and experience over a long span of years and not be dreamed up by a group of actuaries in a conference room at the O'Hare Airport.

The question that we have to face as a profession, and as a committee, is should we be seeking to establish principles for the conduct of the business

or should we be seeking to set standards for the quality of the actuarial work that is done by actuaries? That is really our task here. You may be aware that the Academy has put together a committee that is looking at the question of actuarial standards. This would clearly be one of the areas that would be involved.

The Committee is at a crossroads at this point. We are looking at the question of standards. Let me just give you a sense as to the issues. Instead of saying that we have a principle and the actuary's report deals with disclosure of the extent to which his particular set of recommendations fit with that principle, we would ask the actuary to prepare a report to his client describing the particular recommendations that he has. In that report, the actuary should describe the plan for operating the business, the extent and/or the approach to the business, what the implications of that plan are for investment operations, for underwriting, for administration, for distribution, and how he would propose to develop analyses of experience as to what actually happened on the business. The report would also describe the degree to which the recommended non-guaranteed benefits or premiums would permit the client's profit in marketing objectives to be met, and the impact of these recommendations on applicable regulatory requirements. When you get into the redeterminations of premiums or benefits, the report should describe the extent to which the plan or approach established initially for the business was followed, and if it was changed then the effect of that on the investment, underwriting, administration and distribution practices, etc. We do not see how one could approach a business without having a plan as to how you are going to run it and what experience you are going to look at, to see how you are doing. Although in each of these changes you are looking at prospective experience and not retrospective, there has to be some plan and approach and, although it can be changed from time to time, quality actuarial work would require that that plan has been followed. These are two very contrasting approaches. I think the Committee is divided at this point as to which is the right one to pursue.

We have been at this job a long time. Some of us have been there the whole eight years, and we are getting a little tired. At this point we expect that we will come to a conclusion between these two approaches and make a recommendation to the Society Board this Fall on the subject.

MR. TOZER: I would like to throw the topic open for discussion now.

MR. E. J. MOORHEAD: I have five questions and I would be quite prepared to be told that some of them are not in the scope of this session in which case I will take it philosophically. The questions are prompted by things said this morning that surprise me a bit.

1. Claude used the expression "that separation of accounts would be helpful", and I wondered why the word "helpful" was used in that particular context. It seems to me that separation of accounts might be considered more essential to the resolution of this question.

2. Since the policyholders have not been left out entirely from the discussion so far, but have turned up somewhat on the side, I wonder if it would be possible for somebody to say when this is all

finished, where does the policyholder and the prospective policyholder stand in the matter of being able to separate the attractive policy propositions from the unattractive ones?

3. I have read somewhere that the Federal Trade Commission is turning up in this field again, and I wonder whether the panel attaches any great importance to the question of what might happen as a result of the Federal authorities taking a fresh look at the question.

4. This question has to do with an attempt that I have been making recently as editor of The Actuary, to get some comments from readers of our publication as to how important and how valid the Belth Bench Marks are considering the desirability of maintaining an existing policy rather than replacing it. I have had somewhat disappointing experience with respect to the number of people who are willing to make any statement at all. I am not completely devoid of them but it has not produced a very strong response.

5. I was wryly amused by Harry's reference to shrill criticism. I had thought that the whole question had reached the stage of yawning rather than of shrillness. I wondered whether he was talking about a recent shrill criticism or something that dates back into the days when I was active in this field.

MR. THAU: The first question regarded why I referred to separation of accounts as possibly being helpful in this process. The key reason is that Section 1.3 of the guidelines makes it clear that the guidelines do not involve themselves with the issue of how much surplus is available to be distributed. They are only involved with: given a certain amount of divisible surplus (that has been decided through some other means in which I would think separate accounts might be more necessary), how do you distribute it among your individual blocks of participating policyholders? In distributing an amount of divisible surplus among your policyholder blocks, typically what you need to know is what were the lapse rates, what were the investment yields, what were the mortality rates block-by-block, what were the average sizes and the expenses, etc. Separation of accounts will not really help you get that unless you do separation of accounts by block. I do not know of anybody who does separation of accounts by block. Usually you have other statistical studies and experience studies in your investment area, on your lapse rates of your policies, and on the mortality experience of your policies. You can use that data to get your experience factors from which you can create a dividend scale by way of a three factor formula or an asset share approach or whatever. So the focus of separation of accounts, in my opinion, is on an aspect that is specifically excluded from consideration under the guidelines.

MR. STENSON: My own view on where the policyholder should stand with these new policies is colored a bit by the mutual mentality. To the extent the guidelines and requirements for Universal Life type policies and SPDA types of contracts require that companies not change their profit objectives on a given block of business, the more comfortable the customer can feel with the initial illustrations. Is that a proper concern of the actuary as a professional or is it a separate regulatory concern? I think Harry was referring to the question of the actuary as a professional versus his or her responsibility to management. The actuary should be concerned with giving a good

solid report and explanation of the implications of what he or she is doing with this particular business to management.

I did not know that the FTC was getting involved in this particular arena at that time. To the extent they do get involved, their interest would probably be more with customers.

I cannot really comment on the Belth Bench Marks. I have not looked at them in detail myself. In general, I have found that whether it is better to replace or not depends on how long a viewpoint you are willing to take. With some of the newer products, if you are willing to look far enough ahead and be optimistic enough they look terrific, but they may not look so good if you take a view of what is going to happen if money is needed next year.

MR. THAU: With respect to disclosure, my understanding is that would fall in the Academy's sphere more so than in the Society's. I expect more discussion of the buyers guide, Schedule M and such like that, to come up later on in our Academy Committee discussions.

MR. GARBER: Jack, we certainly did not regard your comments as shrill comments. Most of the shrill comments have been related to the newer issues. Dividend comments have always been of a reasoned variety.

The issue you were concerned about was the comparability of illustrations. The Committee in the end faced up to that and found that the world had changed considerably. If we were basing things on the Contribution Principle, the way the world was leading was to finer and finer differentiations of experience. These finer differentiations made it very difficult to make illustrations comparable. In the end the Committee felt that that was one issue they had to give on; there was no way in which to try and create comparability of illustrations and still permit these finer differentiations of experience. The issue of comparability of illustrations is one the Committee has decided was not possible to deal with.

My understanding is that the FTC involvement is part of the hassle in Washington over the unisex rates. This is a little bit of the politicking that is going on. I do not know that the FTC has decided to get back into the illustration business.

MR. DONALD D. CODY: I was fascinated, Harry, with your recitation of that kernel of a new idea because it impinges on some other areas that I have been vitally involved in. In accordance with our recommendations, whoever is responsible for a dividend scale in a mutual life insurance company does make a report to management. I do not recall whether we have ever indicated how extensive that report is to be, but it is inevitable that a fullsome report of that kind is bound to get into a commentary about the good sufficiency of reserves and the surplus policy of the company with respect to that line.

By the time a report of this kind is made, if the valuation actuary's responsibility is expanded under our principles and standards, then he too will be writing a report on the good sufficiency of reserves. I think it is inevitable that he then get into management of surplus which appears to be developing into a discipline for actuaries. I just wondered as to who eventually will be responsible for this report. You think of the person who

signs the dividend report to management in a mutual company as a pricing actuary. You think of the person who may sign these potential valuation actuary's reports as a valuation actuary and begin to get into the corporate actuarial concept. When you get into the corporate actuarial concept and you start talking about surplus, you are dealing with the long range plan of the corporation and the financial officer. I too have been concerned with this kernel of an idea. Where does this leave us? I think you are on an area of discussion here that is going to become vitally important over the years.

MR. GARBER: I think, on the specific question on dividends, we need to talk by defining the position that once the dividend amount has been established, we are really dealing with how to distribute it. The pricing actuary in that stage starts with a number. We are really dealing with what to do once that number has been determined. We are not overlapping, yet, but clearly all of those functions are important to consider in the role of the actuary.

MR. STENSON: I think that that covers the distinction as it stands now. Obviously, there are a lot of people that may be involved in a process that would have to be brought together. But, as Harry said, the dividend recommendations at this point in time are aimed primarily at equity among groups starting with an appropriate pot of divisible surplus; the valuation actuary is dealing with solvency and how much do you need to assure it.

MR. TOZER: As a point of clarification, the 13A dividend recommendation is pretty much the same recommendation that is currently in use for mutual companies. The main change is to modify it to cover both mutual and stock companies so it becomes a recommendation for all participating insurance, not just mutual company insurance. So, the changes are not that major in the dividend area.

No one seems to wish to take a stand on the role of the actuary and his professional responsibility in this area of pricing products after the date of issue. How does the actuary's role fit in as a professional vs. a company employee? Should he be stating whether or not this is an acceptable actuarial approach or whether this is simply a description of what has happened? I think that the earlier recommendation basically tried to establish "a criteria of acceptable actuarial practices" and the actuary had to disclose then when he deviated from those practices. The new recommendation is basically simply to describe his approach and not make a statement of whether this does or does not comply with "acceptable actuarial practices".

MR. MICHAEL WINTERFIELD: This is a 13B question. I would like to probe the comments about the profit margins a little bit. You were saying under the new guidelines that the profit margin should be essentially fixed at the time of issue. I am wondering what kind of flexibility we might have with this in terms of the changes in our renewal interest rate settings? For example, when we see situations where our portfolio rates occasionally get higher than the new money rates, we are inclined to try to open up the margin a little bit in order to cover the other situations that always come up where the new money rates are a lot higher than the portfolio rate and we are forced to reduce the margin. The question, then, is if we start out

with a profit margin of X that might be mainly the interest margin, are there any opportunities to open it up to X + Y and then reduce it to X - Y at other times, on a lifetime type basis?

MR. STENSON: Well, clearly under the alternative that Harry sketched out, that could be part of your plan. The whole point of the alternative would be merely to make sure that you have put down in writing a plan that would approach this cohesively so that management knows what is going on and that you tell them when you change it. In terms of the recommendations as they are now written, that particular point would not come in unless you reduced the interest rate below what you illustrated at issue. When you sell a contract, it is keyed around a set interest rate. There is the implication that you should not go below that interest rate unless anticipated experience changes. You should not increase your profit margins at the same time as you are reducing a benefit to the customer, unless you are doing that to line up with new business. Some of the states, New York for instance, have more specific requirements now, telling you that if you change those margins at all, you have to tell them about them, and get them approved.

MR. THAU: I have a question for Harry on the new idea that he is talking about. You mentioned, in giving some of the background, that part of the stimulus for this was agitation on the part of regulators. The several purposes for developing guidelines are, in some cases divergent, in some cases, just solely independent, and, in some cases, overlapping. If we were to make the guidelines focus more narrowly on actuarial reports, how do you think the regulators might respond? Secondly, I think there was also some hope on the part of some people that the guidelines would provide a safe harbor for actuaries who, in case of potential legal action, would have an authority that they could point to. Also, they could point to it if they felt their management was doing something they might feel was irresponsible; this gets us back to some degree to the regulators' concerns. The alternative that you are talking about would certainly, to some degree, be less responsive to these groups and I thought you might want to comment on that issue.

MR. GARBER: First as to how the regulators will react, those who pay any attention to it will say we have copped out and have not done the job we should have done. There is no question about the attitude that will come from there.

The second point gets to be interesting. I was sitting in on a meeting of a Disciplinary Committee of the Academy yesterday and I think there is a clear feeling among the Committee members that the question of discipline will change over the next decade or so. Now we deal with great commissions and omissions on the part of the actuary. There are beginning to be a number of questions about what sort of a job did the actuary do, not did he do the job at all or did he fail to file reports or did he go to jail or steal money, but, how well did he serve his clients and did he do the kind of professional job that should be done. This new Committee of the Academy is looking to the area of trying to define actuarial practices in a fashion that will set some standards as to how well the job gets done.

When I was outlining the alternative, what I was really trying to outline were a set of measures that might be there if an actuary does make a set of

recommendations in the area of non-guaranteed benefits and charges. These are the things that should be in his report. One then needs to go beyond that and give the actuary some ideas as to ways in which those things might be carried out. For example, there may be several different approaches that could be used in developing a plan for dealing with a line of Universal Life products. There is more than one certainly and those probably need to be identified for the actuary. But, certainly, if he submits a report without a plan, that is not quality actuarial work that would be expected and his client would then have reason for a complaint. The question here gets to standards as to what represents the quality of actuarial professional work that a client should expect from his actuary. This is the way in which we ought to be moving rather than trying to set a principle as to how the business should be conducted and having things fall from that.

MR. MOORHEAD: If the state authorities feel the profession has "copped out", doesn't that matter?

MR. GARBER: I think that we have to make a choice as to what is more important for us to do. Our goal in life is to substitute facts for appearances. If you have a set of developing products, experience has to be developed with those products. Observations have to be made and then conclusions drawn; principles must then be set out. Sitting down at the beginning of a product cycle and trying to draw principles that should be used confines the companies and puts the actuary in a position where he is liable to be at sore points with his employer constantly. I think that it may well be that the regulators are expecting too much of us, or expecting us to perform a kind of role that a professional society should not be asked to perform. The experience on which we would base our judgements is not there. I think we really have to look at what we can do and what we cannot do in terms of what our role in life is and what our professional obligations are.

MR. JAMES W. PILGRIM: The U.S. industry will find itself in five or ten years with appointed valuation actuaries similar to the situation in Canada. Maybe that is the role that the actuary in the company will be playing in the future so that he can have that position and feel that he can render opinions in a little bit more independent fashion while still being an employee of the company.

MR. THAU: I think there is a third alternative. Basically, the concern for the current guidelines, and where the shrill criticism comes in, is that they define a single approach or a single philosophy, if you will. They say that all you have to do is disclose what you are doing if you are doing something else. But there is the implicit understanding, which is likely to be picked up by other people, including regulators, that if you are doing something else, you are wrong because you are not following the mainstream. I think some of the criticisms are coming about because contrary philosophies are established. Companies have established philosophies that tend to differ from 13B and they do not want to feel branded as doing something that is actuarially improper and not following generally acceptable actuarial guidelines.

The alternative that Harry has proposed basically says just report what you are doing. There is no philosophy or generally acceptable actuarial prin-

ciples involved in actually doing the work. It is just reporting the work.

Another alternative that has come up is to make it very clear at the beginning of the guidelines that there are a variety of approaches that are being followed. Then you could say here are several different approaches that people are using and there is a consistent philosophy within each one. The actuary would be in a position to point to those as a safe harbor. It would be a more structured approach for the regulators and yet it would leave ample room with much indication that there are a variety of approaches and that other approaches in fact will develop. I would say this falls in between the current guidelines as structured and Harry's approach. I would think that this may be more acceptable to the regulators. My impression is that the regulators are becoming more and more significant. With the original guideline, the regulators are going to expect us to follow it without deviation. With Harry's alternative, they are just going to strike out in their own way and in many cases, inconsistently with one another. With this other approach that I am mentioning now, I would think that the regulators might say, there are all of those philosophies but we do not like this one. Thus, you can do anything but this one and disclose to us. If you do anything that is not one of the methods that we have found to be acceptable, disclose what your philosophy is to us when you do your filing.

MR. GARBER: We know how uncomfortable we would be at this point had we been stuck with the British form of participation here as the only dividend method that was permitted, or the percentage of premium method or the two factor formula. That would then be what we had to follow or be branded as not following actuarial practices. I do not want to be extreme on this but I think in newly developing areas the danger you run into is that if you bless everything that is there and then something new comes along that is outside the scope, it is therefore deemed to be inappropriate when it may in fact be better.

Jack, you are the historian here. You may want to comment on when the three factor dividend formula came in to dividend practice but my guess is it sure was not there in the first five years of participating business and that had some group such as ourselves set down the acceptable methods at that point, then we may never have seen the three factor dividend formula.

MR. MOORHEAD: I believe that the history of this is of more than just trivial interest. The second actuary of the Mutual Life, Sheppard Homans, who later became the first President of the Actuarial Society, went to England to discuss with the long established companies over there what methods should be used for the distribution of the developing surplus of the rather newly formed American companies. This was in the 1850's. He came back with a method called the Jellicoe method, which is a kind of a crude two factor system; then he and his assistant, David Parks Fackler, went to work and somehow between them developed the contribution system and produced it at approximately the same time as the American Experience Table came into being. It just happens that for those of you who do not read The Actuary, and there are some here, I recommend that you, if you are interested at all in this, do read an article by Ardian Gill which is about to be published in our next issue and which deals with a very exciting struggle that I think Harry would think fits very well with his remark about being in sore points with management. The struggle initially was between the actuary of the

Mutual Life, Sheppard Homans, and the President of the Mutual Life, Fredrick S. Winston. I will not try to prejudice your thinking by mentioning it, but I will mention it anyway that Mr. Winston eventually landed in jail. But, the question on how the contribution system should be applied was a matter of large objection between those two gentlemen and the result was that they were both complaining to the Board of Directors of the Mutual Life. Mr. Winston decided to bring in expert testimony on the point. He brought in the Professor of Mathematics at Yale, the Professor of Philosophy at West Point and the Professor of Mathematics at West Point to support his argument.

A large struggle developed involving what might be properly called the leading mathematicians of that day. Those gentlemen, one of them was named Bartlett, not however any relation to Dwight Bartlett, supported President Winston and not Sheppard Homans. Thus Winston could be said to have won the day.

Before the matter was finally behind them, this had been thoroughly aired in the New York newspapers of the day. The New York Times had a great deal about the controversy in its columns and it did not do the fledgling life insurance business any good at all, just as controversy such as this being hinted about this morning would not do the life insurance business any good at all. But, those of us who are interested in the history of our profession as a profession, I think would be interested to know that one of the effects of this struggle between those respective strong-minded people was a material delay in the organization of the actuarial profession, in that David Parks Fackler, and I think with Mr. Homans' concurrence, decided to postpone the formation of the Actuarial Society until he was sure that Bartlett was out of the way. He retired in 1888 and the Society was formed in 1889. Elizur Wright, who had taken a very strong part in all of this, was out of the way; he had died in 1885. So the thing is not just a matter of amusement though there is a great deal of amusement to be gained from some of the ways this is expressed and I think Ardian brought this out extremely well in his article. I am devoting more space to that article than I usually am willing to do for a single item because it does deal with this matter of sore points between the actuary and his management and there may be some lessons to be learned.