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Thinking A Lot About Risk Lately, Too

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SOA PRESIDENT BRAD SMITH made some thought-provoking comments in a recent Letter from the President (*The Actuary*, February/March 2012 “The Nature of Risk”). In particular, as a result of his “thinking a lot about risk lately” he pointed out some potentially uncomfortable realities concerning hoped-for avenues of growth for the actuarial profession:

- A sample of very large insurance companies’ CROs shows that only about one-third were credentialed actuaries.
- To date, the CERA designation is still working toward one of its original purposes: to broaden the designation’s appeal to a meaningful number of non-actuarial professionals.
- Research indicates barriers to entry for actuaries in pursuing enterprise risk management (ERM) in nontraditional areas, including a perception that our education is not relevant to non-insurance related industries.



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Among the conclusions was that these facts suggest a re-examination of an idea that has enjoyed some prominence in the past decade, i.e., that actuaries can penetrate non-insurance-related ERM (the example

given being ERM for a hypothetical candy bar manufacturer—I use airlines when discussing this possibility, myself). A corollary conclusion was that growth may be more readily achieved by increasing focus on the markets we currently serve.

I’ve spent about 30 years in nontraditional work, including my current job designing and marketing risk management systems for hedge funds, so I’ve been thinking a lot about risk lately, too. Now, one might expect a “nontraditional actuary” to take issue with the foregoing conclusions. However, my experience suggests that President Smith’s points are not only well-founded, but if anything, they could be expanded to include some of the broader challenges facing our members and our brand.

More specifically, I think the prospects in new and/or non-traditional areas are in some ways a reflection of trends in the traditional insurance and pension areas and therefore must be addressed together. I believe that even well before the financial crisis, many of our members’ traditional employers had reached a very mature stage as a result of the maturing demographics of their end-customers. Top-line growth flattened out in many lines of business. Where there was high growth it was sometimes accompanied by large losses, such as occurred in early long-term care products and certain forms of variable annuities.

It’s logical that as end-customer-driven demand for our traditional employers slows, so too, does these employers’ demand for actuarial services. The good news is that the actuarial profession is not suffering the full effects of this slow-down in end-customer demand because there is currently a boom in “process-driven growth,” i.e., new opportunities arising from regulatory, governance and financial reporting processes.

While there is no substitute for strong end-customer demand, process-driven demand does have its attractions. Just consider what process-driven demand has done for the accounting profession in the form of Sarbanes-Oxley. CPAs are now an integral part of the corporate governance process. Any process that absolutely requires a professional’s signature can be very good for that profession, at least in the short term.

But process-driven demand has disadvantages as well:

- Because it brings costs and complexity to businesses, it rewards scale and consolidation, rather than development of new products and markets.
- With consolidation large companies grow larger, but fewer in number, with a net reduction in higher-level jobs industry-wide.
- Smaller entrepreneurial companies are disproportionately burdened, reducing opportunities for some of our most creative members.
- Some may view the nature of process-driven work as less intrinsically rewarding than market-driven work.

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Also, while it is tempting to think of the ratcheting-up of regulatory and reporting complexity as the very embodiment of the mythical “Actuaries’ Full-Employment Act,” the ultimate outcome can be far different. Actuaries of my vintage can remember the ERISA boom that was to guarantee the careers of anyone working with private sector defined-benefit plans. In retrospect, ERISA actually foreshadowed the peak of employer willingness to offer private sector defined-benefit plans. Likewise, perhaps, there may currently be big opportunities at the outset of U.S. health care reform, but in the long term it is easy to imagine scenarios (e.g., single payer) that would greatly decrease the demand for health insurance actuaries. And while all the solvency and accounting changes on the way may create voluminous initial work for some, they may also cost others their jobs permanently by reducing the returns available to their employers.

I see a connection between demand in the traditional industry environment and President Smith’s concerns over the prospects for actuaries in new areas like broader risk management. My experience is that at least some CERAs, as well as many nontraditional actuaries, in general, have pursued those directions not because they wish to avoid traditional actuarial work, but rather because the market for such work has changed in the ways indicated above.

So I think we must not only re-evaluate the path to growth in new areas, but also examine the growth trend in traditional areas. Too often it seems to me that we have defined our growth in terms of supply, e.g., number of new fellows or exam-takers, and not by the demand for our services. In this column I’ve speculated on the trends in demand, both the level and the nature of the demand, but this is simply my own conjecture. I think we need to get a better understanding of the future demand side of the equation in both new and traditional areas in order to determine how best to protect and build our brand for our current members, as well as being realistic regarding the standards for students and helping them understand the prospects they can expect. The financial crisis punctuated an era of significant change in the business models and fortunes of many of our profession’s traditional employers. It also accel-



erated the rise of ERM and spawned new areas of process-driven demand for actuarial services, even as it further pressured end-consumer driven demand. As I agree with President Smith’s call for a re-examination of our potential new avenues for growth, I see the issues involved in this effort and the issues facing traditional areas as two sides of the same coin, both looking vastly different than most would have thought 10 years ago, both facing challenges worth a closer look. ■