RECORD OF SOCIETY OF ACTUARIES
1989 VOL. 15 NO. 2

SMART POLICIES AND A SMART POLICY

Speaker: DAVID R. CARPENTER

MR. DAVID R. CARPENTER: As the title to my speech suggests, I had intended to talk to you about changes in product, product-type policies, and what a smart actuary will do to deal with them on down the road. But as I worked on the speech, I realized that much of what I could offer you, you already know. And my regard for you as fellow actuaries is far too great to bore or patronize you. So as I worked on my talk, I realized that this was really a chance for me to talk with you about professional issues that are of great importance to me personally, that are crucial to us as actuaries, and that even affect, I believe, the continued viability of our entire industry. And in doing that, I will cover or touch on most of the major topics in your program. Remember, my views are strictly personal and are in no way endorsed by the SOA or any other organization.

If that isn't enough, I've added some more. I'm going to toss the cat in with the pigeons. I'm going to be very frank and give you my personal thoughts and beliefs about how our profession has been deficient in its responsibilities, or maybe put more nicely, not capitalized on what I perceive have been its opportunities. And that lack of courage and failure of action are spelling trouble with a capital "T" for our industry, our profession, and for each actuary as an individual. I'm most hopeful that you new Fellows and Associates in the audience will listen very, very closely.

Finally, I want to share with you my thoughts on the clout the actuarial professionals should have on the future of the life and health insurance industry. If some of what I say upsets you, I can only hope you'll channel that anger in a positive way. But I tell you this because I like being an actuary, and I like actuaries as people, more than any group I have ever been associated with. And I care very, very much about our future. We all know that doctors, lawyers, and accountants have clout because of their sheer numbers. The last I heard, there are 250,000 CPAs in the U.S. We could try this route, I suppose. All of us could go home from this meeting and explain to our spouses that it's absolutely necessary that we get on with our responsibility to propagate the actuarial species. I can tell from the snickers that some of you have already tried that. But it loses its effectiveness very soon, and that's not the approach. Seriously, we're not going to accomplish our objectives through numbers, but rather through our ability to handle numbers in a highly disciplined manner. We have a great reputation as a profession, not because our forefathers were fathers four times over, nor because of the discipline of actuarial science itself. We have a great reputation because of the discipline of our actuarial forefathers. There's a great deal of talk within the profession today about the skills and career orientations we should be looking for in those whom we are attempting to recruit into our profession. The argument goes something like this. We recruit far too many mathematicians, and not enough people who have business skills. In thinking this through, I found it far too simplistic. I've got to tell you, we need both of those skills, and we need them in bigger, better quality than we have ever had before. I was reminded of the old story about what you get when you cross a parakeet with a lion. I don't know either, but when it talks, you listen. I submit to you that those hybrids are exactly what we need, and we do not need even 100,000 of them. A strong math background is absolutely important. We need in our actuaries a balance of financial strength and analytical skills. At the same time, we also need to develop actuaries who have the discipline to know when to speak up, how to speak up, and when not to speak up. The majority of actuaries are far too apathetic. Sadly, often those who do speak up are misguided at best.

In browsing over the program for this meeting, I am intrigued that most of the topics which will be under heavy discussion are on the agenda because, in my opinion, my generation of actuaries has not done a very good job. And I know that, because I was involved in a number of those issues, I'll take part of that blame. A very important issue to all of us which may not receive much attention at this particular meeting has to do with the effective reorganization of the profession, or more generally speaking, the plan for the future of the actuary, as I referred to earlier. Folks, I've got to tell you, this is nothing new, as you might suspect. In fact, more than a decade ago (I didn't take the time to look it up) as a member of the Board of the SOA, I had the privilege of working with Barbara Lautzenheiser and others in the creation of a reorganization proposal termed, "The ARC Proposal." That proposal was basically the same as the current loose talk on the subject of the need to strengthen the profession. How did we lose all this time? Because our fellow professionals did not trust one another. The ARC Proposal was feared to be a Trojan horse by some very influential actuaries and, therefore, fell from within. Ladies anda gentlemen, I submit to you that we have met the enemy, and it is not us. In his short treatise entitled, "All I Really Need to Know I Learned in Kindergarten" Robert Fulgrum suggests, "When you go out into the world, watch out for traffic, hold hands, and stick together." The profession lost a major opportunity over a decade ago to get on with this hand-holding. The good news is, those of us who worked so diligently to create the ARC Proposal are still around, and we have survived fairly nicely, thank you, but will you? The traffic is bound to worsen. Get tough. Although I have many friends who are accountants, for instance, as far as I am concerned, as a profession, I don't like them and I always will, as Sam Goldwyn would say, "They are in my back yard, and they are in your back yard." I think it was Benjamin Franklin who once said, "Your right to swing your arm in the air ends with the tip of my nose." And they are bloodying my nose, and they are bloodying your nose. And you only negotiate through power. They don't dislike you. They don't dislike us. They have a lot of respect for actuaries. That's not the issue. The issue is, they want the world. What if you had 250,000 mouths to feed?

I'll tell you something else, too, and this isn't funny. It's happening right now, and I predict it's going to be a major movement. One of the most powerful positions in the life and health insurance companies of any size will be the Chief Financial Officer(CFO) position. In my humble opinion, one reason for that is chief actuaries haven't gotten the job done. You say, "Well, we'll just become the CFO." Well, you can. But if you are going to try to go that route, you need some more education, because a lot of those CFO jobs are no longer going to actuaries. They are going to CPAs, because they are getting the job done.

Although my record is far from spotless, I have in the past attempted to call attention to the fact that life insurance actuaries are pricing their products at a loss in many situations. Several years ago, we at Transamerica Occidental were forced into a defensive position called Select and Ultimate Term. And it has taken us and the industry at least seven years to work our way out of that mess. Will you leave this meeting committed to responsible strategic pricing? It's the eleventh hour, folks. Do you know where your expenses are? Many don't. More to the point, we must learn what our expenses can be. The days of cost-plus pricing are over. You know, that's what we did for most of our history -- cost-plus pricing. Those days are over. The marketplace is going to set the price in most situations within some reasonable degree, maybe 10%, 15%. I don't know what else you've got going for you. The marketplace is going to set that price. That means you have to manage the expenses in under that price level.

Furthermore, several of us have tried to shed light on the absurdity of the current situation with regard to life insurance company taxation. Although I have more to say on that later, I'll get you thinking now by saying that this definitely is an issue that is extremely complex, granted, and has been mishandled.

And while I don't want to seem like I am up here whistling "What a Wonderful Guy Am I," I am proud of the fact that I did stand and was counted, and it wasn't very comfortable at the time, in the fight against unisex pricing, rather than rolling over and playing dead as many did. And I was also proud of the fact that a lot of my brethren along the way, when presented with the other side of the argument, the side I was on, did come around. That shows the degree, I think, of fairness that actuaries have in addressing issues. The army of indifference recruited many during the unisex pricing battle. There are times when basic principles are more important than social mood. As far as we know, women live longer because they are women, period. And I feel it's crucial to stand and fight for that argument as it pertains to life insurance at this point in time. That is not to say that later we won't have to change that position. For instance, if we could come up with what they would call biological risk classification, biological underwriting, where you ignored things that we now know of as being the only parameters we can use, it might go away. But we're not there. Nobody knows how to do it.

Look at the problems you are going to be discussing at this meeting, and you will see why it is absolutely imperative that all of us in this room recommit ourselves to the frightening prospects and boring rigor of speaking out on important issues for which we have been uniquely trained. Keep that in mind as you examine all of the unintended consequences of our past actions and inactions. Currently, we have a huge problem regarding lack of capital and lack of profits in our business. I submit to you that we are a major cause of that problem, in that too many of us have lacked the courage or simply have not had the appetite to pound on the table and say, "We are pricing at a loss or at an insufficient profit margin to sustain our business over the long haul." Even the California Supreme Court was smart enough to say the property liability industry deserves a reasonable return. I know it isn't always a matter of courage. There's been confusion; confusion of accountability, complex terminology, complicated tax rules and regulations, and just the environment in which we are working today. All these factors make it difficult to be an actuarial pit bull on important issues like pricing. Or maybe it's just not knowing how to speak up; I think that's part of it. But you are going to have to overcome that, collectively and individually, and make your voice heard above the crowd. Women and men, dissent is not dissension.

Possibly more serious in this regard, I believe that our technical skills have let us down. That's so important, I'm going to repeat it. I believe our technical skills have let us down. I still hear actuaries speak lovingly of pricing definitions that are not in any way related to a sufficient return on capital to sustain the business. Unless we have mechanisms in place that allow those types of measurements, not only will our companies be jeopardized, but our profession will be jeopardized as well.

Related to this major issue are cost comparisons and disclosures. This is another problem with which I became involved about five years ago. We attempted to contribute to that problem, we thought, to a positive, speedy, commonsensical resolution. What was the outcome of our involvement? I'll confide in you that I was so discouraged by what I would characterize as a triumph of form over substance with regard to the implementation of the product that I withdrew from the effort. Others took up the cause, thank goodness, and last year the Academy and the NAIC took action. How many of you have taken these developments to heart? How many of you are even familiar with them? You'd better be. They are absolutely imperative with regard to the future of our profession. There will be a lot of talk at this meeting about the vicissitudes of FASB 97. My question is, where have we been? Where was the organized leadership to stand up to the accounting profession with regard to this strange turn of events? You know when I knew we were in trouble? I knew we were in trouble when I heard several people, not all actuaries either, but several knowledgeable, powerful people saying that the FASB is invincible. Only Superman could have known that. The accountants are now in the business of designing life insurance policies, for that is exactly what happens under FASB 97, and if you think that actuaries, or even an individual actuary, can't have an impact on FASB, I would refer you to what a man named Harvey Rosenfield and his initiative named Proposition 103 did to the entire property liability industry in the state of California, and probably throughout the nation, working out of a garage in Santa Monica, California.

Let's talk a little bit about boring rigor. Our health insurance brethren look like they are on their way to a train wreck. One of the biggest reasons that we are in the mess that we are in with health care is that the voices of actuaries weakened and faded prematurely, I'd say around 20 years ago, regarding the long-term dangers inherent in first dollar coverage. I remember; I gave up myself. Now I realize the difference between responding to market pressures today and guiding my company back to sound practices in the long run. You have to stick with what you believe in over and over and over again, forever and ever and ever.

Here's another example. Look at the problems our casualty comrades have. They've made this for themselves because they have stubbornly held on to the concept of not discounting loss reserves because they have not yet found an effective way to convince their company managements to adhere to sound reserving practices.

You know, we can take a great deal of pride in the survival rate of our companies compared to that of the banks and the savings and loans, but we do need to get our own act together or we may end up in a similar boat. There is already talk of that on the street. I've heard it said, "Is it really true that the insurance industry is the next savings and loan industry?" And with a history as long as ours, and with the consequences of our decisions sometimes taking a decade or decades to show up, we all know we need to talk and think in terms of years as well as months and quarters. Here's a quote from a back edition of *The Wall Street Journal.* It may freshen your perception on this particular point. The *Journal* was quoting Franklin D. Roosevelt, who said, "As to guaranteeing bank deposits, the minute the government starts to do that, the government runs into probable loss. We do not wish to make the United States government liable for the mistakes and errors of individual banks and put a premium on unsound banking in the future." So it isn't like something we just discovered today, folks. That was before the legislation was passed.

While I'm on that subject, our industry has already been forced into an unfair competitive environment because the banks and savings and loans have deposit guarantee insurance from the government. Now that those kinds of institutions are moving into our business, and they are moving into our business, and now that there's a proliferation of agencies rating us, it's imperative that those ratings be credible. Those of you who have dealt with the rating bureaus know that many of their techniques are extremely questionable in today's financial environment. Have we spoken up as a profession? Not to my knowledge. Why not? The leadership of the Academy, the Conference, and the Society can determine how best to proceed. But I strongly suggest that they are already late in approaching this very serious problem with an organized effort that would be both helpful and heeded by those rating organizations if approached effectively.

I'm not saying this next one is all our fault as actuaries, but where were the casualty actuaries when the powerful social mechanisms that ultimately allowed Proposition 103 to become law were set into motion in California? Where were we? It's no news to anyone in this room that the public relations of the property-liability insurance industry are atrocious. But the worst part is that the life and health insurance industry has been tarred with the same brush that has blackened the property and liability image. The good images of your companies and clients have been dragged down, and we as professionals have done very, very little to prevent it. Again, I'm not laying Proposition 103 and our industry's tarnished image at the actuarial doorstep, but we have to share in the blame, folks. We just have to share in that blame.

Here's another one. Let me ask the pension actuaries in the audience -- how much were you involved when the country moved relatively swiftly toward defined contribution pension programs to the detriment of defined benefit pension programs? Did you speak out? Did you do it effectively? Did you do it collectively, or as an individual? As professionals, we should have spoken up really, really hard. We know in our hearts that society in general has a need for defined benefit pension programs, yet we let uninformed do-gooders and ambitious regulators annihilate those programs.

Most of you know about this mess, but I'm going to talk about it anyway, because it might make me feel better. Actuaries, as well as lawyers, can certainly share the blame for having created one of the most incomprehensible tax environments since the beginning of man. To this day, I don't think the actuaries and lawyers understand what a disservice this has been to their companies and the industry in general. What I am about to say next, my people told me not to say, because I would appear prejudiced. I decided that I must say it, if for no other reason than I am encouraging you to speak up when you think something is truly wrong. Concerning the taxation issue, I don't care about our fancy definitions and elaborate arguments. The plain facts are that a segment of the companies are not paying anywhere near their fair share of federal taxes. And those tax savings are being used to compete unfairly by offering lower net cost products and by hiding surplus in the creation of value that will be returned to the companies at a future date. Put more bluntly, the IRS is financing the creation of a significant amount of new business. I think that is extremely shortsighted.

It reminds me of a story that is supposedly true about a man named Jose, a Mexican, who had come across the border and helped build a school in Brownsville or one of the border towns down in Texas, and he stayed on as custodian. And one year the students invented a little game they thought was really funny. At recess, a group of them would go up to Jose, and one of them would hold out each hand, and in one hand he'd have a nickel, and in the other hand he'd have a dime. And he'd say, "Take one Jose; take whatever one you want." And he'd take the nickel. This went on for about five or six weeks. One of the kids started to feel bad about it, because the kids were always laughing at Jose; they'd run away laughing. So finally, one day he hung back after this little exercise took place, and he sort of embarrassingly said to Jose, "Jose, I want to tell you something. Although the nickel is bigger, the dime is worth twice as much." And Jose said, "I know, Senor, but if I take the dime, they'll quit playing."

That group of companies I'm talking about shouldn't take the dime. Now, having said that, I'm going to surprise you by my next suggestion. Overall, the taxation issue is one in which we should learn it's time not to speak up. The issue is far too political in nature for actuaries to be the point man. Rather, I strongly suggest that our general demeanor should be one of passive service to the major constituents -- Congress, the Treasury, and most importantly, the CEOs for whom you work. I predict that we will never get to a life insurance company tax law that is manageable until we let those parties define it for us conceptually. If their proposed concepts are faulty, then we should substitute facts for impressions.

Regarding virtually all of the issues we have discussed, don't be depressed. Defeat is temporary. Think about it. In almost every one of those issues, defeat is temporary. The game isn't over. My favorite dialogue from the movie, *Bull Durham*, is "Sometimes you win, sometimes you lose, sometimes it rains." I'm telling you, folks, it's raining. Certainly, effective action is more difficult late in the game, but the game hasn't been played out. Now's the time to address and properly resolve many of these issues.

I don't want to leave you with anything less than a full play, so I'd like to tell you a little of what I see in the near term future. Most of our future lies ahead. That's a quote from Danny Krub, the Louisville basketball coach. Most assuredly, we are entering an era when we will be competing with other kinds of businesses. Certainly, it appears we will be in competition with banks. A sizeable number of actuaries will be working for a bank within five years. So what do we have to do? Actuaries will have to broaden their expertise and perspective. We are all in sync, now, I think, with regard to change. We have accepted that as well as most. Change is inevitable; there's no doubt about it, except maybe from vending machines. There's no rule that says actuaries can't dream. Mark Twain said, "You can't depend on your eyes if your imagination is out of focus." Here's an example. I believe product is much more than the policy form we traditionally think of and the premium rates that go with it. If that's true, where does that take the eye? Learn to financially analyze the business the way a takeover artist would. It will scare you, but you will then be in a position to help your CEO save your company. And I believe most of you in this room lack the skills to do that. You're going to have to brush up a little, but it can be done. You're certainly smart enough to learn how to do that. Do it as soon as you can. Become familiar with the mindset and tools of the investment community. Study the techniques of banks and brokerage houses. They do product faster than we do. Just for an example, how did they come to be able to do that? You don't have to like your competition to learn something from them. Learn as much as you can. I don't particularly like either one. Did you hear the story about the guy who called his stockbroker the day after the big crash in October of 1987? He said, "Is Harold there?" And Harold's secretary said, "Well, Mr. Smith, I really hate to tell you this, but Harold committed suicide last night." "Oh, OK, thanks." And he hung up. The next day he calls again. "Is Harold in?" The secretary, thinking he's probably in just as much shock as everybody else, said, "You must have misunderstood me, Mr. Smith. I thought I told you yesterday that Harold has committed suicide." "OK, thanks." He hangs up. The third day he calls again, "Is Harold in?" By now, she's had it. She said, "Mr. Smith, are you sure you're OK? I've been telling you day after day, Harold has committed suicide." Mr. Smith said, "I know, I just like to hear it."

Do you know return on equity? Do you really know what it is, how it works? Do you know how important it is if you need capital? I know. Know embedded value. Most of our businesses are such that they have significant embedded values that are different from most other businesses. You are probably going to need to be very conversant with that concept and with your own embedded values in order to raise the capital that you and your clients need. Learn to equate ROI, present value of premium, and dollars per thousand to measures the rest of the world understands. I'm talking, as well, to those of you who work for mutuals, because I predict that for most of the ways you're going to find palatable to get capital, you're going to have to be conversant with these concepts. In summary, as someone once said, "The past should be a guidepost, not a hitching post." I think Wayne Gretzky put it better: "Skate to where the puck is going; not to where it's been."

Coming in to the home stretch, let me offer this. I suggest the smart policy for you to adopt is to be responsive to and for you to get involved in the smart policies that I've just mentioned. Question, participate, speak out. Help save your industry; help save your CEO; help save your own hide. Someone once said, "Functionaries transact; leaders transform." In the coming years, actuaries will have an opportunity to be the leaders in shaping the changes our industry most certainly will experience. Whether you are associated with a company that's a big rich or a little niche, you have the opportunity to make a difference. A fellow by the name of Rosenoff once said, "At times, although one is perfectly right, one's legs tremble." It's important to push ahead when your legs are trembling. Your efforts and emphasis should be on strengthening your company and our industry, not on dazzling analysts with earnings pyrotechnics. Speak up. It does take courage. You probably heard about the guy who said, "The trouble with my profession is, no one will speak up, but don't quote me." Write letters to the editors. You haven't been doing that. I know. Do you know how I know? Because I read a lot, and I hardly ever see FSA behind a name in any of those Letters to the Editor columns. Why aren't we speaking up as individuals on issues we know are important, whether it's the property-liability insurance crisis, the Social Security problems, or health care?

I saw an article in the *Times* on my way out of town, and I feel guilty (this was a week ago) because I couldn't respond right away. But the guy was right on with regard to the fact of what's wrong with our health care system. But the fallacy was that he automatically proposed, "When are we going to socialize this thing like everybody else has done?" with the implication that was going to solve our problems. Well, folks, I've got to tell you, I have relatives in Sweden. Sweden is one of the richest countries, one of the most beautiful countries you will ever see. There is virtually no poverty in Sweden. But my wife's dad almost died two weeks ago because he was 82, and they don't have room in the hospital for people who are 82. You can break a hand if you are 40, and they may not set it because it's not life-threatening. In the U.K. (I believe this is correct; there's enough here who can correct me if I'm wrong, later), I think if you are over 55 you cannot get kidney dialysis. Folks, I'm 50. I care about that. So when you write in, be sure to put your credentials in there, and spell them out, because we want the public to know that was an actuary who wrote that letter. I did write on the 103 thing. There was an editorial in the *Los Angeles Times* (and I'm only giving you that name because it was the *Los Angeles Times*; I'm not trying to dig into them or anything) right after 103 passed which said that the unfortunate part about the passage of 103 was that it would probably hurt the small California insurers the most, and they probably gouge the consumer the least. So I wrote to the publisher of the *Los Angeles Times*, who I happen to know, and I said, "I'm not in the property-liability industry; I want you to know that. But I do believe in a sense of fair play, and I believe your editorials should be as unbiased as possible. And although I have not done a scientific study, I'm pretty sure that I'm safe in saying there must be at least one property-liability company in California that does not gouge at all." He got the point; at least I would like to think so, because they ran some excellent educational articles after that on the problem that had very good balance. But they didn't even realize how their bias was showing, just boom, right in the middle of the editorial.

I want to talk a little bit more about the boring rigor of leading and impacting. Let me ask you this. Don't all shout out your answers. There's no prize. Which actuaries stand out in your mind historically as being the greatest actuaries we have ever had in our profession? I'll bet, in most cases, those actuaries had a consistency about them. They not only had a cause; they might have even been a little bit on the outside. But I think of somebody like Bob Meyers, or people like that who just consistently hung in there, pounded away for what they believed in, created unbelievable respect for themselves and also for our profession. I can think of the ones at my company, the ones they still talk about. Even marketing people talk about them; can you believe that? Can you imagine how good they must have been? I've got to admit; they were characters. A lot of them were really characters, but they spoke out and they stuck by their story for years. That is boring. The most boring thing, I found, about being a CEO is the same thing. You cannot change the culture of a company or set its direction by just getting up and saying something once. You've got to say it over and over and over, and for most people who would like to think they're somewhat intelligent, that gets boring. But it's got to be done. So the other thing we've got to do is don't give up the battle prematurely. Just keep hanging in there; keep punching away consistently.

The senior managements of each of your companies or clients are counting on you to give them the best of your thinking. Push for your ideas and your conscience. Stand up and be counted. In fact, the real test of courage is to continue to stand up after having been counted. If you fail, you won't get beat up. You probably won't even get sent to the executive penalty box. After all, I'm up here at the risk of being interpreted as having a highly personal and unreasoned distortion of judgment. It's a risk I'm taking. But, ladies and gentlemen, I stand here because of my pride and affection for a profession that I chose when I was seventeen. In fact, I was talking to Ian last night. I thought I had him. I thought I was a permanent employee of The Lincoln before he was, because I was a permanent employee of The Lincoln in 1957, straight out of high school for six months before I went to college. But he's been there since 1956, so I didn't catch him. When I went home at the age of seventeen, and I said that I might become an actuary, do you know what my dad said? He said working for a life insurance company would be a great idea, because they were one of the few institutions that not only made it through the Depression but helped the country get through that Depression as well. I thought that was pretty impressive. It really hit home to me, especially since he'd lost a house in the Depression. I thought it was a powerful endorsement, and I think the actuarial profession can take a lot of credit for that. We have helped establish that strength. In the past years, I always enjoyed attending conferences such as these, because actuaries are such high-quality people. One of the sad things about being a CEO is you often have to forego such pleasures. And I think somewhere it should be written, "The best shall serve as actuaries." I don't care whether that sentiment ever gets chiseled in stone, but I do think it should become part of the actuarial work ethic, and we should do everything we can to make that sentiment a reality. I want to thank you; I want to wish you good luck. Have a great meeting, and return home committed to assuring, indefinitely, our ability to respond when asked, "I am an actuary," and feel that warm inner glow that assures us we made a great career decision.