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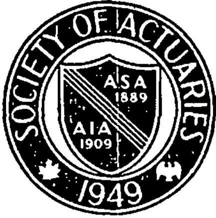

The Actuary

The Newsletter of the Society of Actuaries

VOLUME 1, No. 4 — JUNE, 1967

REPORT ON ACCREDITATION

by Andrew C. Webster

The unsuccessful attempts to obtain a Federal Charter have already been reported to the members, as has the action of the Academy in obtaining an Illinois Charter. Thus armed, the Academy has endeavored to obtain recognition by means of legislation in various key states, and in so doing, we have the blessing of the N.A.I.C. To date we have not been too successful, although we have in Indiana a statute providing for the certification of Actuaries. The legislation sought parallels that of the C.P.A.'s in that it is permissive legislation requiring certification for the public practice of actuarial science. This does not forbid others from practicing actuarial science for employers, but it would prevent the noncertified actuary from signing certain reports.

State recognition or licensing of any profession — law, medicine, architecture, etc., gives the state the right to determine who shall and who shall not be certified or licensed according to the standards set by the state. This is a sovereign right of the state and a right that will not be ceded to any private organization. In C. P. A. practice, for example, the state uses examinations furnished by the Institute of C. P. A.'s and it is most likely that for Actuaries the Academy examinations will be used. There is, however, no guarantee of this in connection with any profession. Actuaries are no different from any other profession, in relation to the state, and the state's right to certify is the price of recognition of any profession.

The legislation will be a local matter, i.e., there is no model bill which will be proposed in identical terms in every state. Basically, each state bill will define the public practice of actuarial sci-

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THE ACTUARY IN MANAGEMENT

by Keith J. Harding

The following is an abridged version of a paper presented to the Younger Actuaries Section of the Canadian Institute of Actuaries on March 28, 1967.

It has, of course, been proven that actuaries can make their contribution in just about every area of a life insurance company's operation. This should be attributed, however, in many instances to their abilities as men and not to their actuarial training, although the latter must make its contribution. I am concerned with areas in which actuaries might be making a greater professional contribution to management.

Many of the following notes have been inspired by *Management Control in the Life Insurance Branch Offices* by Professor James S. Hekimian, a book published in 1965 by the Graduate School of Business Administration, Harvard University. Although the book is a study of those techniques and procedures which are intended to ensure that the efforts expended, costs incurred, and results achieved by branches accord with management's desires, questions are raised relating to the overall management of a life insurance company.

Corporate goals—Is there any reason why a life insurance company should not set out to make a profit in precisely the same manner as a manufacturing company? It has been suggested that there is some conflict between profit and growth, but this I would question. Surely growth should be such as to optimize future profit development since life insurance, like any other business, will normally re-invest part of its profits to enhance its future growth.

Is it possible to measure the profitability of the business currently being underwritten by a life insurance company? With increasing pressure from competition, it would seem essential to assess the potential profit in relation to the cost of new business. Are we in danger of arriving at the position where we would develop a greater potential profit by investing in long term bonds the money we are spending on procuring new non-participating business?

Why is there any less justification for a mutual company to pursue profit as a corporate objective than there is for a stock company? I believe that there is considerable justification for any company to pursue profit because surely one of the requirements to maximize profits is an efficiently run organization. Competition will play its part in ensuring that our customers receive a fair deal.

Whatever the attitude of life insurance management towards profit, there would seem to be a much greater tendency in our industry to think in terms of growth than in terms of profit. At this point I would merely question how long we can go blithely seeking greater volume without paying increasing attention to the costs of obtaining it.

Consideration of the cost of acquiring new business gives rise to some other interesting questions. I cannot help but wonder whether it is not the level of our expenses which is driving investment dollars away from the industry. If we subscribe to the theory that it is our business to sell protection, have we not some responsibility to ensure that the public can purchase it at a price they can afford, even if it means rethinking our whole marketing philosophy? Maybe we could improve the efficiency of our marketing methods, particularly for the lower income brackets. If this is so, must we not also rethink some of our corporate goals?

Planning — I propose to consider only the planning necessary to ensure that

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EDITORIAL

The workshops, introduced as an experiment at the spring meetings, are a welcome attempt to restore the spontaneity of earlier meetings. With rare unanimity the younger members have enthusiastically welcomed these workshops. We hope that the experiment will be continued and extended.

In its early years our predecessor Society was a smaller community of actuaries who met to discuss problems informally. This open atmosphere gave the younger actuaries an opportunity to develop their thinking and test their ideas in discussion with senior members.

Since the Society has grown larger it has become increasingly difficult for the younger actuaries to derive the same benefit from informal discussion. Much of the value of unrehearsed comment and constructive reaction is lost when "informal" discussions consist largely of the reading of carefully prepared statements.

Some of those who participated in the workshops suggested that senior members be present to temper the debate and lend depth to the discussion. This is a good idea. Although leadership and initiative in the workshops should remain with the more recent members, a few seniors, chosen for their experience in the field of discussion, will enhance the sessions.

Since a greater variety of subjects will make it easier for participants to select an area in which they are particularly interested, we would suggest that simultaneous workshops on the same topic be avoided. As a minimum there should be at least one workshop for each of the areas of major professional endeavor — individual insurance, group insurance and pensions.

The effective leadership of the spring meetings did much to contribute to their success. The choice of leaders of the same quality should continue. Also, we hope that the agenda will continue to include topics of controversy, lest the discussions degenerate into a mere recital of business methods.

Perhaps participation in each workshop should be limited to no more than one man from a company. This will promote unfettered discussion of controversial topics. Similarly, the policy of reporting the discussion without attributing statements to individuals will help to foster the free atmosphere of the sessions.

The workshops are a welcome innovation. They promise to contribute much to the profession in the future, and have already been a service to those who participated at the spring meetings. — J. B. C.

CANADIAN TAX PROPOSAL, Part III

By J. Ross Gr

The Canadian report on taxation by the Carter Commission notes that life insurance companies have been free from federal taxation except with respect to the profits paid to shareholders. Mutual and foreign companies have been completely free. The Commission feels that this is too good a source of taxation to miss.

Accordingly, in addition to the taxes to be levied directly on policyholders as mentioned in the previous issue of *The Actuary,* it is proposed that there be tax levied upon the profits of the Companies. It is recognized that this will be passed to the policyholders either in the form of lower dividends on all policies or higher non-participating premiums on future policies. The recommendation is that the companies be taxed at the usual 50% corporation tax rate on the excess of surplus earnings over policy dividends disbursed.

In determining surplus earnings, reserves will be set up on the net level premium basis on at least 4% interest, a no contingency reserves or special serves will be permitted. No attention is to be paid to the reserves which are needed to cover the cash values.

The Commission dismisses any worry on this point; solvency is a matter for the supervising authorities, it has nothing to do with taxation. It is apparently of no moment that, because of being forced to pay taxes based on 4% (or higher) reserves, a company's asset position could be reduced below the reserves needed to cover the cash values.

Taxation of the Canadian companies is to be based on their worldwide business, with suitable adjustment of the interest rate for reserves on foreign business. Reference is also made to an allowance for taxes paid to foreign governments on foreign business. Thus, it is hoped that Canadian taxes will not affect foreign business operations.

Canadian operations of foreign companies are now to be subject to Canadian federal taxation, probably based on a proportion of their total company operations rather than on their Canadi operations alone. In addition, to the extent that assets are held in Canada in excess of actuarial reserves, the income

on such excess is to be taxed at the usual withholding rates applicable to non-residents. There will also be a special tax which is applicable to the branch operations of all foreign businesses.

The hope is expressed that all foreign companies will be able to obtain credit for these Canadian taxes in their home territories. The taxes will, therefore, not fall on the foreign companies but on the treasuries of the foreign countries.

Perhaps, this account should finish with the thought which was expressed at the beginning; it is not certain that these recommendations will become law, they are just too far-reaching. In one respect, the Commission has decreased the chance of the ideas being accepted; they have said that it is necessary for their entire package to be accepted, otherwise that harm will be done.

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ence. Definitions may vary, but not too much. They should be broad, bearing in mind that the Academy membership includes actuaries in other than life fields, and also that enumeration implies exclusion.

These two items, the rights of the state, and the definition of the public practice of actuarial science seem to have given rise to most of the misunderstanding. There have been other questions, mostly of administrative procedure within the state, and these will have to be answered individually.

Two recent items are encouraging from the view point of actuarial recognition. One of these is the requirement under Senator Javits' pension bill, now before the Senate, calling for actuarial valuation of pension funds and giving a proposed pension commission the right to accredit actuaries. We have already asked to be allowed to file a statement about the American Academy of Actuaries at the hearings on the Javits' bill.

The other lies in the tentative draft of the Civil Service Commission, *Classification Standard for Actuaries.* The draft was submitted to the Society, and the Public Relations Committee and the E & E Committee have suggested recognition of the Society and of the other actuarial bodies in setting up standards for employment and for promotion.

MANAGEMENT . . .

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the field force is making the maximum possible contribution towards the corporate goals. Are we providing our agency officers with sufficient data to enable them to reasonably assess whether a certain area of development is likely to make a profit or a loss for the company?

In many instances the agency officer may have little more guide to corporate goals than the relative level of commissions which the company is prepared to pay for different types of policies, and I would seriously question whether the level of commissions for various policies really reflects the profitability of the particular policies to the company.

The apparent concentration on volume rather than on profit would appear to have had its effect on the planning activities of companies. The long range plans of many companies would appear to consist of very little more than the projection of future sales.

In an attempt to show that there are other ways of motivating a field force than by constant emphasis on increased sales, Professor Hekimian proposes a formula which, he submits, can be used to develop the potential profit from any policy which is placed on the books. In essence, the formula develops the present value of the difference between the cost of the benefits and fixed expenses, such as commissions, and the premiums, using projected mortality and interest rates. By deducting the appropriate amount for the cost of the head office and branch offices, and expense not directly related to new policies, we are left with what Professor Hekimian labels the "expected contribution to profit."

Professor Hekimian submits that if this information is developed for each branch and made available to the branch manager, the manager is then in a position to make reasonable decisions regarding the amount of business which must be produced in return for additional expenditures. It is not my purpose to question the formula because I believe that it is the idea behind it which is important. If we are dealing with a reasonable caliber of branch manager, we should be able to place him in a position to make decisions regarding the financial development of his operation. Maybe, as a first step, we should ensure that such information is available to our agency officers.

Communication—In his closing chapter Professor Hekimian states "On the basis of my experience with companies in other industries, communication in an insurance company is relatively poor.

"This is truly unfortunate because each of these departments (the reference is to the sales and actuarial departments) can contribute towards solving the problems of the other, and it seems that proper communication among the departments should enhance the overall management job within a company." A prime example of this might be the necessity for an actuary to communicate effectively with the investment officers of his company to ensure that investments are consistent with liabilities. Much more has been written on this subject in British actuarial journals than on this side of the Atlantic and I sometimes wonder if North American actuaries pay sufficient attention to this side of our business.

It is perhaps equally or even more important that an actuary should communicate effectively with the agency officials of his company. I cannot help wonder whether we might find it easier to communicate with our lay colleagues if we were more ready to translate our net premium valuations into terms of realistic mortality, interest and expenses.

I have questioned the communication between actuaries and their non-actuarial colleagues, but might we not also question the communication between actuaries and the public. When we create new plans and products do we always pause and listen to what the public wants, or do we tend to offer what we feel they need?

Conclusions — I do not for one moment want to suggest that we should lightly discard any of the tradition which has been built up within our industry over the past couple of centuries or so. I do feel, however, that we are now living in a completely different world than that in which much of our tradition was developed.

The sole purpose of the original paper was to provide the basis for a worthwhile discussion amongst actuaries, many of whom are looking toward the future with the determination to play their part in the building of better and more effective life insurance companies.

SEGLI MORTALITY EXPERIENCE, CALENDAR YEAR 1966

Mr. W. A. Poissant, Chief Actuary, Veterans Administration, submitted this mortality experience of Servicemen's Group Life Insurance for the calendar year 1966 as being of interest to Companies writing military business.

Branch of Service	*Number of Deaths*			*Death Rate per 1,000 Exposed*		
	Hostile[b]	*Other*	*Total*	*Hostile*	*Other*	*Total*
Total experience[a]						
All branches	5,008	5,587	10,595	1.5	1.7	3.2
Army	3,073	2,206	5,279	2.4	1.7	4.1
Navy	120	1,300	1,420	.2	1.6	1.8
Air Force	134	1,431	1,565	.2	1.5	1.7
Marine Corps	1,681	586	2,267	6.2	2.1	8.3
Coast Guard	—	56	56	—	1.6	1.6
Public Health[d]	—	8	8	—	1.4	1.4
Viet Nam only						
All branches	5,008	1,045	6,053	16.1	3.3	19.4
Army	3,073	665	3,738	17.7	3.8	21.5
Navy[c]	120	124	244	2.6	2.6	5.2
Air Force	134	80	214	3.6	2.1	5.7
Marine Corps	1,681	176	1,857	31.5	3.3	34.8
Other experience[a]						
All branches	0	4,542	4,542	0	1.5	1.5
Army	0	1,541	1,541	0	1.4	1.4
Navy	0	1,176	1,176	0	1.6	1.6
Air Force	0	1,351	1,351	0	1.5	1.5
Marine Corps	0	410	410	0	1.9	1.9
Coast Guard	0	56	56	0	1.6	1.6
Public Health[d]	0	8	8	0	1.4	1.4

a. Deaths and exposure for the 4 months post-separation insurance are included
b. As classified by the Department of Defense
c. Includes Coast Guard
d. Includes Environmental Sciences

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