

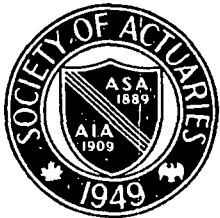


SOCIETY OF ACTUARIES

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ACTUARIES CANNOT SELL ANYTHING

by Arthur Pedoe

One of the subjects for discussion at a recent meeting of the "Younger Actuaries" of the Canadian Institute of Actuaries was "Actuaries Cannot Sell Anything." As one of just two "older" actuaries present I was moved by the expressions of frustration from the younger members of our profession when they are pitted against the salesmen of mutual funds and so-called "advisers" to pension funds. The sense of responsibility of these younger actuaries appeared to them to be a handicap, and the frustration when the business went elsewhere left its mark.

Perhaps this sense of responsibility can be carried to an extreme. One of the younger actuaries was concerned at the possibility, when arranging a pension plan for an employer, that the plan might prove too costly and in a period of business decline and financial stringency might even bankrupt the employer. How different from the salesman whose success is governed solely by the magnitude of the sale and who is inclined when he meets resistance to throw caution to the winds and allow his optimism as to the future to soar to the skies!

In the last ten years life insurance has been losing ground as a long-term savings medium and the actuary's caution may be blamed as the cause. At a recent Society meeting figures were quoted indicating a doubling of life insurance assets in the period compared to a greater increase in almost every form of saving and a ninefold increase in the assets of mutual funds.

But the reason for this is not the actuary's lack of salesmanship but the curse of inflation. I would agree that most top executives of the life insurance

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THE FIRST AMERICAN ACTUARY

by Frederic Seltzer and Steven I. Alin*

Dr. James H. Cassedy's article, *The Actuary*, May, 1969, on "Actuarial Science in 18th Century America" has prompted us to further research. We have focused our attention upon two of America's earliest actuaries.

The Pelican Life Insurance Company of London was founded in 1797 and in 1809 extended its operations to the American continent. In its "Articles of Association" the position of actuary was defined: "The actuary shall receive all applications for insurance and annuities, and make all necessary inquiries respecting the same, under the instructions of the Board of Directors, calculate the respective premiums and prices of Annuities, and report the same to the Board, and if approved, prepare the policies and Bonds which shall be signed by the President, and at least one director, and countersigned by said actuary." On March 10, 1812 the Pennsylvania Company for Insurance on Lives and Granting Annuities, chartered as an outgrowth of Pelican Life, appointed as its actuary, Jacob Shoemaker. To our knowledge, he was the first American actuary to have the title.

The Pennsylvania Company was a small operation, however, and it was not until the formation of the Massachusetts Life Hospital Insurance Company in 1823 that sizable actuarial operations were performed.

Massachusetts Life sought Nathaniel Bowditch, the renowned mathematician of Salem, Massachusetts as its actuary. After several months of negotiations, Dr. Bowditch accepted the position for the sizable sum of \$3,000 annually and Massachusetts Life began operations in August 1823. During his 15 year reign

*Mr. Alin is a student of the Society.

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OPINION 8 AND ADJUSTED EARNINGS

by Mary Hardiman Adams

Two accounting problems were discussed at the May meeting of the Actuaries Club of New York by Henry F. Reiss, Jr., C.P.A., of Ernst & Ernst, and E. R. Miller, C.P.A., of Peat, Marwick, Mitchell & Co. They discussed the accountants' problems and their approaches to actuarial practice in connection with pensions and life insurance.

Mr. Reiss, whose topic was "How Accountants Deal With Problems Arising from the Implementation of Opinion 8", said that in examining the actuarial information required by the Opinion, one of the items which accountants look for is consistency from year to year in cost methods and actuarial assumptions. Particularly, however, they are concerned with the materiality of any differences between the actual level of funding and the required level, computed in accordance with Opinion 8 of the Accounting Principles Board. His firm, so far as actuarial assumptions are concerned, is interested only in changes which may have a material effect on liabilities and contributions, except with respect to interest where they look for a realistic valuation assumption (10 per cent could be too high!!)

Ernst & Ernst also looks for consistent treatment of both realized gains and losses and unrealized appreciation in funds. Unless changes in benefits or contributions, assumptions or cost methods occurred during the year, the form developed by his firm to collect pertinent information requires only the unpaid past and prior service costs, the actuarially computed value of vested benefits and total annual contributions.

In computing the value of vested liabilities, most actuaries use a "going concern" basis which is the intent of Opin-

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Actuaries Cannot Sell

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industry have become smug and complacent regarding the effect of inflation on the more than thousand billion dollars of life insurance in force in their companies. Everything seems to be going so well why incur resentment by attacking inflation? Stopping it is bound to hurt someone!

British Treasury 2½% bonds redeemable after 1975 and issued in 1946 now trade at less than 30. Allowing for reduction of purchasing power they have in real terms only 12% of the value at which they were issued. On this side of the Atlantic it is not so bad but bad enough. U.S. Treasury 3% bonds of 1995 issued in 1955 now trade at below 70; the real loss to anyone who bought the bonds when issued is of the order of 50%.

Is it any wonder the public are losing their faith in fixed dollar life insurance? Does the move to equity-linked life insurance contracts meet the problem? The financial editor of a prominent newspaper during this June stock market fall praised the mutual fund managers for "keeping their cool" and not panic selling which might well have brought on a stock market crash with dire consequences to industry and finance. He added:

"That is all the more encouraging considering how much concern was being expressed, quite recently, about the speculative activities of some of the younger and more raucous fund managers, who sounded more like race-track touts than investment advisers."

Younger actuaries please note!

I recently returned from a visit to England where this problem of old-line life insurance versus the newfangled equity-linked contracts was drawn to my attention. As one who for over thirty years has stressed the desirability of equities (common stocks and real estate) as investments for life insurance company assets, I am in favour of equity-linked contracts but see the danger of salesmanship outrunning discretion. I have been in favour of life insurance companies and their agents moving into the mutual fund business if only to introduce a greater sense of responsibility.

In Britain for decades the life companies have been substantial investors in equities and reaped remarkable rewards. One well-known company announced at its last annual meeting that its common stocks and real estate investments together amounted to over 50% of its assets, book value, and 70% on a market value basis! Also in Britain dividends are allotted in the form of paid-up additions to the sum insured which would offset the inflation threat.

The average results of nine leading British companies on a 25 year endowment insurance, age 29 at entry, and maturing in 1969 (old line currency basis) showed that the sum insured and dividends on maturity represented a return of 5% per annum compound interest on the premiums paid with the life insurance thrown in! The guaranteed sum insured increased by dividends, on the average, by 3% per annum thus covering that amount of inflation. With such results one would have thought that mutual funds and equity-linked contracts would not have the attraction over there that they have on this side of the Atlantic where common stocks represent a mere 5% to 6% and real estate some 3% of assets.

Yet mutual funds or unit trusts as they are called in Britain have attained a surprising magnitude: over one billion pounds. I was shocked in Britain to see huge advertisements for mutual funds in the most conservative newspapers, more suited to copy for a gambling joint. One was headed: "No Man Should be Without a Fortune." Another large spread by the same company was headed: "The rich get richer . . . and here's how to join them." This company has very recently established its own life insurance company to include insurance benefits in its contracts.

Another company which commenced life business in 1962 advertises its unit plan as follows (for comparative values I take \$5 to the pound): "Making \$80,150 is Easy (Try it and see). It means investing \$50 a month with us and \$80,150 could be your reward . . ." They do use the word "could" and not "would". It is only fair to add that other mutual fund advertisements in Britain are more sober than the three mentioned here. Yet in one of these mentioned the company refers to itself as "Britain's leading unit trust."

During my stay in Britain a substantial fall in Stock Exchange prices occurred. The well-known London financial weekly *The Economist* of 21st June stated that the "all share" index had fallen by 25.4% since 31st January, the all time high; the net new investment money in mutual funds from January to May had fallen from 33.3 to 9.7 in millions of pounds. *The Economist* commented, "It will take small investors some time to heal their wounds and come back for more—just about from now to the next market peak." A chart showing how net new investment money varies directly with the common stock price index—the largest sales when the price is highest—is headed: "When will they learn?"

The situation on this side of the Atlantic is similar. There is the story that the Indians of the Great American Plains when they went on a "war path drunk" arranged for at least one of their number to stay sober. There is another story of President Lincoln interrupting an argument as to the proper length of a man's legs with the comment: "I guess they should be long enough to reach to the ground."

In these "Go-Go" days we need more of the actuary's sense of responsibility, not less. Let the actuary at least, be the one "sober" party at a meeting of executives and let him keep both feet firmly on the ground and not be swept away by the salesmen's talk that in this "new era" things have only one way to go and that is "up." □

First American Actuary

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at Massachusetts Life, Dr. Bowditch became a familiar figure throughout New England. His keen business sense, coupled with his scholarly activities contributed materially to the success of Massachusetts Life. His dictum "In selecting investments, the question of immediate income is given careful consideration, but a greater amount of time and thought is directed to the study of how to conserve and secure the growth of purchasing power of the principal," is most applicable today.

Do any of our readers know of a U.S. actuary, with that title, earlier than Mr. Shoemaker? Who was Canada's first actuary? □