

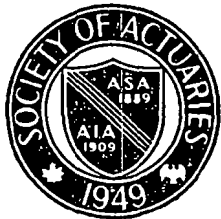


SOCIETY OF ACTUARIES

Article from:

The Actuary

May 1979 – Volume 13, No. 5



The Actuary

The Newsletter of the Society of Actuaries

VOLUME 13, No. 5

MAY, 1979

MONEY MYOPIA—INSURANCE INDUSTRY AND THE SAVINGS DOLLAR

by D. S. Magnusson and D. E. Steven

Ed. Note: This is the gist of the authors' presentation to the Actuaries' Club of Winnipeg. The discussion was described as "contentious." Some argued that we are in the protection business and should not enter the shorter-term fund accumulation process, particularly on the ordinary side. Others approved of providing alternatives to other savings institutions and discussed the consequent investment problems.

Myopia means "deficiency of foresight or discernment." One can review the last 50 years and conclude that our industry has exhibited a degree of myopic behaviour concerning the savings dollar in Canada.

Individual Products

From the early 1920's to the mid-1950's, individual products demonstrated a relative lack of change or improvement. There was, however, good reason for the success of Retirement Annuities and Retirement Income Endowments over most of this period. Following the Depression, the customer's greatest concern was security, and our industry had an impeccable reputation for meeting financial promises. During the decade following the war, signs of change were emerging, but the cloud of myopia prevented our discerning the future.

The post-war economy provided increased interest rates, and banks, trusts and credit unions started attracting more savings. Reduced term rates led to "buy term and invest the difference" alternatives. And just when we might have reacted positively, the Department of National Revenue introduced the Registered Retirement Savings Plan—a monopoly for our industry. Instead of focusing on the total issue, we continued to sell, with

(Continued on page 7)

JOHN E. O'CONNOR IS SOCIETY'S NEW EXECUTIVE DIRECTOR

The Board of Governors on May 23rd unanimously approved the appointment of John E. O'Connor, Jr. to fill the vacancy created when Peter Plumley resigned as Executive Director.

For the past twelve years Mr. O'Connor has been on the staff of the American College of Hospital Administrators in Chicago. He holds a B.B.A. degree from Loyola, and is a C.P.A. He will start his duties with us in July.

We welcome Mr. O'Connor to the Society staff. More information about him will appear in *The Actuary* next month. □

IN THE FOOTPRINTS OF GEORGE KING AND SPURGEON

Alistair Neill, F.I.A., F.F.A., *Life Contingencies*, pp. 452, William Heinemann, London, 1977, £10.50.

by William H. Wetterstrand

This book replaces the Hooker and Longley-Cook texts for the Institute and the Faculty of Actuaries examinations. The author was educated both in Britain and in the United States (under a Fulbright grant). His U.S. experience is strongly evident in the book, since it bears a closer resemblance to our Jordan than to the British texts both in topic selection and arrangement. The most striking difference from Jordan is in the new book's practicality, it having been designed particularly for self-study. Many worked examples are given. The exercises are mostly numerical, treating actuarial functions in applications typical of an actuary's daily work, i.e., theory admirably tied to practice.

Naturally, the treatment relates to British practices. Differences in terminology give the book a certain charm for the American reader: office premiums, assurances, bonuses, retirals, and so on. A gross premium model, showing

(Continued on page 6)

THE ART OF IMMUNIZING

by C. L. Trowbridge

The Committee on Valuation and Related Problems, formed two years ago to develop a theoretical framework for the balance sheet of an insurance enterprise, has issued a preliminary report. This report was discussed in a Concurrent Session at the New Orleans Society meeting in early April. Number 1 of Volume 5 of the "RECORD," to appear in the late summer, will contain this report and its several attachments.

The body of the report is seven pages long. Assets are viewed as the present value of the income stream arising from investments held; liabilities as the present value of the disbursement stream arising from insurance and annuity contracts already in force. The most troublesome theoretical problem is to determine an appropriate valuation interest rate.

The difference between assets and liabilities ($D=A-L$) is thought of as an aggregate contingency reserve, having three components:

- C_1 is a contingency reserve for the possibility of asset loss.
- C_2 is a contingency reserve for the pricing of an insurance product proving to be inadequate.
- C_3 is a contingency reserve against the possibility of a change in interest rates, which can be expected to affect A and L differently unless income and outgo flows are closely matched.

The Committee has not attempted to quantify C_1 or C_2 , but has referred each to the Actuarial Education and Research Fund. Research specifications appear as attachments 1 and 2 to the preliminary report. The AERF is asking for proposals on these two matters. (See AERF p. 7).

(Continued on page 6)

Money Myopia

(Continued from page 1)

minor improvements, 19th century products to a populace destined to retire near or in the 21st century. Eventually, our own customers' dissatisfaction led DNR to allow banks and trusts to administer RRSP's during the accumulation period.

Only in the last few years have individual products reacted to this apparent shift in consumer focus from long-term security to net rate of return. The only steps necessary are to observe what the customer wants, what the customer buys, and to decide whether to offer something similar or better. But these involve major considerations.

For example, one response is a no-load, no-fee product which guarantees a competitive rate of return (10¼%) for up to 10 years, renewable at then current interest rates until retirement. As an individual product, this is a major departure from tradition in terms of available compensation, contract administration and investment policy. Whether the industry is prepared to meet this challenge is, of course, each company's decision, but the market is there for those willing to seek it on the customer's terms.

Group Products

Group operations in Canada have been similarly shortsighted in their approach to the savings dollar. The original vehicle, the non-participating Group Annuity, assumed; that the sponsor of a Group Pension Plan would always be considerably more interested in guarantees than in rate of return, that the sponsor would always want to keep his plan with the same insurance company, that interest rates would never change substantially, and that employee attitudes would not change. Time has proven all of these assumptions to be so incorrect that the Group Annuity has become a symbol to the public of the inflexibility of the insurance industry and the major impediment to the successful marketing of more modern Group Pension products.

The 1950's and 1960's were an age of change in the insurance industry's group approach to the savings market. The 1950's saw the introduction of investment contracts of the "New Money" type that have lasted until now, although they are falling from favour due to unnecessary complexity. The 1960's saw legislation allowing insurance companies

to operate segregated funds on both a pooled and separate basis. A vivid illustration of the industry's attitude is that it took so long to acquire this right and, having acquired it, so much longer to use it effectively. While many companies provided the pooled equity funds shortly after they first earned the right, pooled bond and mortgage funds and separate funds for the assets of one client were much slower to appear.

The Group part of the insurance industry is now slowly becoming enlightened as some thought is given to what the consumer wants rather than what the insurance company thinks is best. As a result, pension business is being sought through separate funds in some cases, and through guaranteed products that more closely fit what the consumer perceives he wants. The insurance industry is at least learning what the consumer is buying elsewhere. However, no really innovative thinking is obvious.

The point of this presentation is to challenge the insurance industry, and particularly its actuaries, to abandon historic approaches to the savings market and to think from the consumer's perspective. □

AERF

Projects Launched For Surplus Study

At its quarterly meeting on March 13 AERF (Actuarial Education and Research Fund) approved Requests for Proposals (RFP) for two projects of high importance to the actuarial profession.

The first proposal is for a study of the amount of surplus that should be held by an insurance company to guard against pricing inadequacies.

The second proposal is for a study of the amount of surplus that should be held by an insurance company to guard against asset depreciation.

These proposals were developed by AERF in co-operation with the Society of Actuaries Committee on Valuation and Related Problems, chaired by C. L. Trowbridge. Anyone interested in bidding on these proposals should get in touch with James Hickman, Professor of Business and Statistics, University of Wisconsin, Madison, Wisconsin 53706, U.S.A., who is the Chairman of the Selection Committee. Other members of the Selection Committee are Charles Trowbridge and John Mereu.

Universal Coverage Study

Good news! The actuarial profession has contracted with HEW to do a Congressional-Mandated Study on universal coverage of Social Security.

Section 311 of Public Law 95-216, enacted on December 20, 1977, requires the Secretary of Health, Education and Welfare, in conjunction with the Secretary of the Treasury, the Civil Service Commission and the Office of Management and Budget, to conduct a study and present to the President and Congress alternatives and recommendations for mandatory inclusion of public employees and employers of non-profit organizations in Social Security.

The Secretary of HEW has appointed a Project Director to direct the activities of a group now called the Universal Coverage Study Group, (DHEW Study Group) which will conduct the mandated study.

A proposal made by AERF to the DHEW Study Group has been accepted and one-half of the expenditure has been authorized. The proposal states how the resources of the actuarial profession in the United States can be harnessed to bring specialized and professional actuarial support to the DHEW Study Group. The members of the Task Force assembled by AERF for the project are Preston C. Bassett, Thomas P. Bleakney, Edwin F. Boynton, Hugh Gillespie, James C. Hickman, Thomas D. Levy, Robert F. Link, Morton D. Miller, Robert J. Myers, A. Hacworth Robertson, Richard G. Roeder, Conrad M. Siegel and Charles L. Trowbridge. The Coordinator of the assignment is Stephen G. Kellison, Government Contracts Coordinator of AERF. □

Actuarial Meetings

June 7, Actuaries Club of Southwest

June 12, Actuaries' Clubs of Boston and Hartford

June 14, Southeastern Actuaries Club

June 14, Baltimore Actuaries Club

June 21, Chicago Actuarial Club

July 12, Baltimore Actuaries Club

July 12, Kansas City Actuaries Club