

## SOCIETY OF ACTUARIES

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## INFLATION AND LIFE INSURANCE

by Fergus J. McDiarmid Ed. Note: This is the first of a series of

reflections by actuaries who made observations 20 years ago on portentous questions of those times.

Back in 1958 I presented a paper, "Inflation and Life Insurance," to the Society. In it I said that fundamental changes in our society, our economy and the world, made continuing inflation likely. The long but historically exceptional period of relatively stable money values, which had lasted from the end of the Napoleonic Wars to World War I, and which had a twilight zone up to World War II, seemed to have ended. Our 1958 dollar had less than half the 1940 dollar's purchasing power. Particularly disturbing, after World War II there had been no reversal of the upward price trend such as had followed prior major conflicts.

#### The Prospect 20 Years Ago

All this, it seemed, had broad and serious implications for such long-term fixed-currency media as life insurance, which had grown to maturity against a background of fairly stable money values and expectations that these would continue. This was particularly so for plans whose time span between collection of premiums and payment of benefits was long; term insurance of modest duration was, of course, the exception. I suggested that as a partial hedge against inflation, new insurance and annuity policies be devised in which a substantial part of the reserves would be invested in common stocks. That was at a time when inflation rates were 1% to 2% a year; recent rates, sometimes in double-digit figures, were not then envisaged.

That paper received substantial but very mixed reviews. People engaged in

(Continued on page 2)

To All Our Readers. A Happy New Year! The Editors

## THE ACTUARIAL POLITICIAN

An Interview with W. Paul McCrossan FSA, MP

Ed. Note: This is one of a series of articles about actuaries in public service.

Question: Paul, do you have the honor of being the first actuary ever elected as a Member of Parliament in Canada?

Answer: Yes-perhaps I may claim to be the second as well as the first. In the fall of 1978 I was elected M.P. for York-Scarborough in a by-election. Then in May 1979's general election I was reelected in that same riding.

Q. Why twice in an eight-month period, for goodness sake?

A. Hardly had I managed to get elected to fill a vacancy than the Prime Minister exercised his option to call a more than usually postponed general election, sending me back onto the hustings without much of a breathing spell.

Q. What is the York-Scarborough riding?

A. A riding is the Canadian equivalent of a congressional district in the U.S.A. York-Scarborough, in southern Ontario, happens to have the largest voting population; and perhaps the largest resident population of any Canadian riding.

O. And your secret in getting the nod from the voters in so substantial an area?

A. There were two hurdles-first to win the nomination of my party (the Progressive Conservative) against two others, then to win the election against

(Continued on page 3)

#### "SECTIONS AND DIVISIONS" IDEAS

More than 2,300 Fellows and Associates have given the Society's Task Force on Special Interests plenty to think about. Your answers to our mail enquiry last July were well spread across the range from "hate the idea" to "best thing you ever came up with." Many of you indicated that we hadn't given you enough information.

The Task Force was appointed by the Executive Committee, as part of its longrange planning function, to look into the professional and special needs of all our members, and the various ways in which the Society might better respond to those needs. We were also asked to determine how well-represented various groups of actuaries were, and whether or not the Society could be more responsive and flexible both in representing you currently and in meeting whatever needs might emerge in the future.

After considerable preliminary analysis, we began to consider a concept of "Sections" to meet the professional needs of those who were interested in more specific services than are currently provided. We also began considering the concept of "Divisions" as a possible approach for providing improved representation, by general specialty.

In July, we gave you a brief outline of the concepts of Sections and Divisions. We didn't ask whether you liked these ideas, mainly because they were not fully developed and, certainly, they were not adequately explained. What we wanted to find out was the degree of interest which might exist, if Sections or Divisions were to be set up.

We received comments from 546 of you. Those in favor of our concepts mentioned the Society's increased size, the growth of specialties, and weaknesses in services to some special interests.

(Continued on page 6)



## EDITORIAL

HE EDITOR tells me that each new Society president is obliged to write something profound for *THE ACTUARY*. I have chosen to write about the recognition of actuaries, which seems a reasonably profound subject.

Professional actuaries need to be recognized by society as providing a unique and valuable service. This is hard to bring about because it involves giving people who are not actuaries some idea of what we do and why it is important to them. It is customary for actuaries to say we have done a poor job of selling ourselves to the public. Perhaps so, but I don't think it's really all that bad. Our most immediate publics are our employers and our clients. These publics do value our services; otherwise they wouldn't keep paying for them. This is certainly an acid test of recognition.

The earnings of life actuaries, so far as I can tell, have kept up reasonably with the earnings of other professionals over the post World War II era, despite a manyfold increase in the number of actuaries. Some of the increased opportunities available to actuaries are no doubt due to ERISA, the growth of employee benefits, the number of new insurance companies, etc. But at any rate, we seem to be holding our own in an area that must concern all professionals—are there adequate opportunities for them to make a living in their profession?

The actuaries' relations with the more general public have been somewhat complicated in the United States by the existence of several actuarial organizations, all granting their own designations. The American Academy of Actuaries was set up as an umbrella actuarial organization in the hope it would become accepted as the public spokesman for the actuarial profession, particularly in connection with legislative and regulatory matters. I believe the Academy has become increasingly accepted in this role, both by people in government and by actuaries, and is doing a very good job in carrying out its task. The Canadian Institute of Actuaries has a parallel responsibility in Canada, and carries it out extremely well.

In the long run, however, it is important for us to be accepted as a valid and valued profession by the public in general, in addition to actuarial employers and clients, and government regulators and legislators.

Is the Society of Actuaries doing all it should to achieve public recognition of the actuarial profession? The answer to that kind of question has to be that we can do more. But we are alert to the need. We have a public relations professional on our staff. We are developing a public relations plan which we hope to get ready this year. We are also part of a joint task force on public relations that has been organized with representatives from several actuarial bodies.

All this is very important. Especially important is that our employers and clients continue to respect the utility and quality of our work. The actuarial profession is in a very strong position in that regard and has been for as long as I can remember. However we must remain diligent in strengthening and updating our education and examination programs, our continuing education programs, and our research programs, because these programs are the ultimate bases for the respect which actuaries have earned.

#### Inflation and Life Insurance

#### (Continued from page 1)

promoting the common-stock-based variable annuity thought it wonderful and ordered hundreds of copies. People to whom common stock investments were anathema were vocal in their opposition. Some actuaries regarded the paper as an unfortunate reflection on fixeddollar cash-value life insurance. They had a point.

#### **Reflections of 1979**

How have that paper's ideas and forecasts worked out? For inflation, much too well-since 1958 our dollar has lost 60% of its value, mostly in the last 10 years. As for common stock investments, these worked out quite well for the first half of the period, but their record has been different since then. The stock-based variable annuity in which I took part of my 1970 pension has so far proved to be no inflation hedge. I, along with most others, failed to take into account the inflation-induced surge in interest rates. Since stocks and bonds compete for investors' money, it seems reasonable that if bond interest rates doubled (from 5% to ~ 10%), the earnings multiple at which stocks sold should, on average, go from 16 times to 8 times; that is close to what happened, and this was generally more than enough to offset increases in earnings and dividends.

What then for the future? The adjustment in earnings multiples having taken place, it seems likely that stocks will do better in the 1980's than in the 1970's. Any lowering in interest rates resulting from better control of inflation would help. If things go the other way, and inflation causes interest rates to climb to 15% or higher, then some further decline in stock prices is to be expected; of course, prices of outstanding bonds would dive, too. In the event of runaway inflation, a possibility that no longer can be ignored, stocks would have residual value lacking in fixed currency investments.

The sad fact in these days of chronic inflation is that selecting either bonds or stocks that offer assurance of a positive real return is very difficult, if not / impossible. If such investments are available, I would like to hear about them.