SOCIETY OF ACTUARIES

Article from:

The Actuary

May 1981 – Volume 15, No. 5

COMPUTER APPRECIATION COURSE

News from London is that the Institute's Students' Society, in partnership with Hewlett-Packard Ltd., has arranged a two-day course "to assist in bridging the gap between the range of modern computing equipment and software on the one hand, and the tasks and problems faced by the actuary in running his office on the other."

The course booklet (available on request to this newsletter) contains an editorial by the actuarial organizer, Gary F. Chamberlin, saying in part:

> There can be no doubt that this is a stimulating period to be working as an actuary or actuarial student in any Office which has begun to respond wholeheartedly to the opportunities presented by modern electronic equipment. It may not be too rash to predict that, within the space of 5 or 10 years hence, it will become second nature for the actuary to have the use of a desk-top machine of his own—perhaps a terminal linking him to the Office's mainframe, or a stand-alone computer capable of a wide variety of functions. . . . It is not only throughput and efficiency of work that will be affected by this "Desk-top Revolution." The actuary's whole attitude towards, and view of, the work he is engaged in are likely to be transformed. . . .

E.J.M.

Consumer Group

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sale of high-priced credit life insurance for Annual Percentage Rate (APR) disclosures under Truth in Lending, aimed at showing how much APR's are distorted when prices exceed reasonable levels.

• *Consumer Booklet*: We sell for $5 a booklet, "How to Save Money on Life Insurance." We urge that most buyers purchase annual renewable term insurance and recommend maximum rates they should pay.

• *Health Insurance*: We think commissioners should upgrade the minimum standards in the Baucus Amendment (Public Law 96-265) that would set up a program of voluntary certification of Medicare supplement policies. Benchmark would be a 60% loss ratio.

NICO is not yet a membership organization, but we have built a mailing list from nearly 5,000 persons who have written following our President's appearance on the Phil Donahue and Mike Douglas TV shows. We can accept tax-deductible contributions, and in due course will seek members. We would like to hear from Society members, at 344 Commerce St., Alexandria, VA 22314, (703) 549-8050. □

DEALING WITH INFLATION AND UNCERTAINTY

by Henry K. Knowlton

Ed. Note: These are excerpts from Mr. Knowlton's presidential address to the Southeastern Actuaries' Club on November 21, 1980.

The only thing we could all possibly agree on today about the economic situation is that the degree of uncertainty is high. It is this uncertainty that presents us actuaries with professional problems which cannot be addressed by traditional methods. Yet there is a lot we can do to live with both inflation and uncertainty, and in some sense to accommodate them, which will both enhance our profession and help protect the publics we serve.

Repeal

It seems to me that we should do all within our power to encourage the repeal of both the present Standard Nonforfeiture Law and the Standard Valuation Law. Although both have been amended to permit using higher interest rates, these laws in their current form were devised in the 1940's and date back to actuarial customs of the 19th century. It is only with considerable pain that many non-traditional products can be accommodated within the framework of these traditional laws, and I have no doubt that the public could be better served if these laws were simply repealed, and the constraints that they put on the marketplace thus removed. As an aside, if we could eliminate the Standard Valuation Law, and determine a company's liabilities and assets on a more rational basis, there would be no need for separate statutory and GAAP annual statements. This may be wishful thinking, but it's essentially what has happened in Canada.

Modelling

When asked what an actuary's primary business is, my usual reply is that we're in the business of making financial models. In my view, the largest deficiency in our models is that they are often made in an economic vacuum. We too often set forth assumptions without specifically outlining what economic conditions would support them, and in doing so too frequently end up with assumptions that are inherently inconsistent.

Twenty years ago in profit-testing ordinary insurance, actuaries were assuming an interest rate in the area of 3.75% graded to 3% over 20 years. Our current assumptions are more like 7½% graded to 6% at 20 years, and to 5¼% at 40 years. In an era of increasing interest rates, we continue to predict a downturn of the same magnitude today as we did 20 years ago. If we consider that our financial projections are valid only if our assumptions are consistent with an economic environment which might validate them, then it seems to me that much of our work will not stand close scrutiny.

Three Rules

If we are to live with inflation and uncertainty, and at the time maintain our professional standards, it might help if we followed a few simple rules.

Rule 1. Actuaries should explain their assumptions, both in actuarial terms and in terms of the underlying economic scenario which supports them.

> *Corollary to Rule* 1—One economic scenario must be used to explain all assumptions in any one set.

Rule 2. The probability of any one set of assumptions being correct, and therefore any one answer being correct, is zero.

> *Corollary to Rule* 2—The degree of uncertainty that faces us today requires more than one answer.

Rule 3. The actuary should be ready, willing, and able to explain why his assumptions were wrong, in both actuarial and economic terms.

> *Corollary to Rule* 3—In explaining where he went wrong, the actuary is prohibited from blaming more than one regulatory agency at a time. □