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THE Actuary

Get ready for *Contingencies*

by Dana H. Murphy

In June, when champagne corks pop in celebration of the centennial of the actuarial profession, there will be something else to celebrate: the launch of the profession's sparkling four-color magazine, *Contingencies.* The inception of a first-class publication like *Contingencies* marks a coming of age for the profession.

Published by the American Academy of Actuaries, the magazine will provide the profession with much-needed visibility. The mailing list for *Contingencies* comprises approximately 12,000 practicing actuaries, most of whom are SOA members. In addition, the publication will be sent to the CEOs and CFOs of the Fortune 1000 corporations, as well as chief underwriters, risk managers, regulators, and influential members of Congress. Although published by the Academy, the magazine will cover all aspects of the actuarial profession, including research and other activities of the Society of Actuaries.

Contingencies will be published bimonthly, with the first issue scheduled for mailing in May 1989. Most issues will contain three feature articles showcasing the diversity of actuarial science and demonstrating the applicability of that science to complex social issues. Whenever possible, the topics will reflect the most pressing concerns of the day, as evidenced by media coverage and public debate. Also, each issue will have a more technical "workshop" article highlighting a new area of actuarial research. Like most professional journal articles, "workshop" papers will be peer-reviewed.

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Have we seen the golden age of convertibles?

by W. Theodore Kuck

Most investors give convertible securities less prominence than stocks and bonds in their investment portfolios. The attention span given to learning the intricacies and finer points of this hybrid security is quite narrow. In fact, most of us may not even know that a "golden age" existed or whether it has peaked. It's far beyond our immediate concerns. Besides, why should anyone care?

Every serious investor should care. A closer look at this security class reveals some interesting, relevant and timely information. Convertibles have, in fact, experienced somewhat of a golden age that can safely be measured over 13 years. Lipper Analytical Services, Inc., which monitors the performance of mutual funds by asset class, has revealed that for the 13 years ending December 31, 1987, convertible mutual funds, on average, outperformed the Standard and Poor's 500 Stock Index 16.2% to 15.5%, respectively, on an annualized compounded basis. Further study reveals even more spectacular returns for the nine years ending 1983. For this period, annualized compound returns of convertible mutual funds were 19.9% to the S&P 500's 15.8%. Not only did convertible portfolios experience such attractive returns, but our own evidence of managed convertible portfolios indicates that the standard deviation of convertible returns versus stock returns shows risk levels of convertibles averaging only 70% of the S&P 500 stocks. Traditional beta calculations as a measure of portfolio risk also confirm this. These points lead to the conclusion that convertibles have provided superior returns with less risk.

These attractive total return figures started a stampede of money into convertible mutual funds. Although institutional-size capital, including insurance companies and pension funds, has been slow to move and reluctant to address the perceived complexities and rewards of this asset class, individuals were quickly attracted to the opportunity to realize these kinds of total returns. The impact of mutual fund assets

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Golden age cont'd

troughing again in late 1987. This pattern of performance for small capitalization stocks also held for convertibles. Furthermore, during the first half of 1988 small-cap stocks and convertibles had strong rebounds. Through June 30, 1988, the convertible mutual fund average performance was 13.0% versus 10.5% for the Dow Jones Industrials and 12.6% for the S&P 500. The Value Line Composite Stock Index was up 19.1%.

No trends like the one that began in late 1987, of course, continue in a straight line forever, and since June 30, small capitalization stocks and convertibles have moderated their relative outperformance. However, it is our belief that the longer-term patterns of superior relative performance for convertibles and small-cap stocks were put in place over several years and that the golden age is only in its early stages.

W. Theodore Kuck, not a member of the Society, is Managing Director, Equitable Management Association.

Contingencies *cont'd*

While written for actuaries, the content of *Contingencies* will be selected and edited so it also is accessible to the wider audience on the mailing list. In particular, the editors will aim to place each topic within the broadest possible context, so that those not yet initiated into the delightful world of actuarial logic can see how the kind of analysis that actuaries perform every day can be used to make high-level decisions in both government and society at large.

Each issue of *Contingencies* will also contain departments that will appeal to both actuarial specialists and generalists, plus a roundup of the latest legislative and regulatory news. Regularly featured interviews with state insurance commissioners will supplement the nationally focused material, along with interviews profiling actuaries in unusual lines of work. This sort of interview can suggest new employment possibilities to actuaries and underscore the profession's diversity to the nonactuarial audience. Finally, just for fun, puzzles will stimulate the reader's gray matter to its peak efficiency.

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Contingencies *cont'd*

The editorial content will be enhanced by the eye-catching design selected for *Contingencies*, which will stand out among the competing publications displayed on a busy executive's coffee table.

The magazine also will fill a crucial need for another group: advertisers. For advertisers, *Contingencies* will reach an affluent and influential audience.

The in-house editors of *Contingencies* work closely with the magazine's Editorial Advisory Board to reach important decisions that will shape the eventual look and content of the magazine. Right now, most design elements for the finished publication have been determined; an advertising sales representative has been selected; and the titles for the first year's feature and "workshop" articles have been selected. Here are a few details about the progress we've made to date.

Designing *Contingencies*

We have engaged a magazine designer, Bono Mitchell, to work with us in making decisions about the many elements that determine the look and feel of a publication. We have selected a "nameplate," the logo that appears on the cover of a magazine.

Because *Contingencies* is a hybrid publication – between a journal and magazine – the cover design demonstrates characteristics of both kinds of periodicals. The cover design has some of the formality of a journal, but other elements – such as the inclusion of "sell lines" (brief phases indicating article content) – are more typical of a magazine.

Inside, the format is appealing and accessible, but dignified. The publication has its own singular identity, but avoids the extremes of idiosyncrasy. The departments have several format features that allow the reader to open the magazine to any point and know what kind of material he or she is reading. Further, each department has its own identifying design element (a small silhouetted picture, known in publishing as a "bug"). The design of feature material will vary from article to article and issue to issue, depending on content. Drawings or photographs will be used as illustrations. Other elements, such as typography, will remain constant among articles to unify the total publication and to clearly separate articles and advertisements.

In hope of attracting and holding the widest possible audience and to keep the design simple and elegant, tables and charts will be kept to a reasonable minimum. With the notable exception of the "workshop" pieces, references will not be included at the ends of articles. When tables and charts are necessary to particular articles, our designers will put their heads together to develop an attractive way to present them.

Determining editorial content

Although we hope *Contingencies* will have considerable leeway to respond to important new issues as they reach the public eye (and, in some instance, to anticipate and promote public awareness of an issue), we have prepared a roster of feature articles and "workshop" pieces that will appear in the first year of *Contingencies*. Here is a sampling of tentative titles for articles:

- Features
  - AIDS Victims: A Class of Uninsurables?
  - Something to Celebrate – 100 Years in the Actuarial Profession
  - Three Years Down the Road, Tort Reform Hasn't Really Changed Things
  - The Real Effects of FASB's Accounting Rules
  - New Accounting Standards for Retiree Health Care Costs – Imminent Hazard for Corporate Balance Sheets
  - How Good Are the Life Insurance Rating Agencies?
  - Preserving the Solvency of HMOs
  - Dividend Illustrations – What Do They Really Mean?
- "Workshop" articles
  - What Is the Appropriate Level of Assets in a Pension Plan?
  - Claims-Made Reserving for Medical Professional Liability
  - Explicit Methods for Handling Inflation

Of course, we hope that actuaries in a variety of areas will submit manuscripts or story ideas to *Contingencies*; diversity in style and substance is one of our aims.

Advertising

Early in the planning stages for *Contingencies*, we assessed the magazine's potential advertising revenues. Publications costs are high for a four-color magazine, and we

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Contingencies *cont'd*

wanted to make sure that *Contingencies* would not disproportionately drain funds from other deserving Academy projects and programs. This is an especially important consideration for a nonprofit organization like the Academy.

For this reason, we signed Judy Solomon Associates of Bethesda, Maryland, as the ad rep for *Contingencies*. In her work for other association publications, Ms. Solomon has posted dramatic increases in ad income. Several other ad reps we interviewed wanted quite hefty "media development" fees, so Ms. Solomon's willingness to take on our project on a straight commission basis is a boon for our budget.

In September of last year, preliminary contacts with potential advertisers revealed a keen interest in advertising in *Contingencies*. Prospects include insurance companies, reinsurance companies, actuarial consulting firms, and purveyors of computer software; several companies have signed on to appear in the inaugural issue.

Now, the full-scale campaign to solicit advertising for *Contingencies* is under way. The principal tool for attracting advertisers to a magazine, the media kit, has been designed and printed. To help advertisers target their ads to specific markets, we developed an "ad calendar," which provides advertisers with a general idea of the content of each issue, selected readership demographics, and a rate card that details the cost of various sizes of ads and printing specifications of the magazine.

During the next several months, Ms. Solomon will contact each of the 350 firms identified as potential *Contingencies* advertisers.

Developing guidelines

One of the less visible, but vital, aspects of starting any new publication is fashioning the "rules of the road" that govern such procedures as the selection and editing of manuscripts. To ensure consistency among the articles in each issue (and from one issue to another), as well as to maximize continuity in a world where high job turnover is a reasonable expectation, we have developed three basic documents:

- A style manual that specifies, for example, what terms are capitalized;
- An editorial policy manual that provides guidelines for procedures such as how manuscripts are selected and edited, and how copyrights are transferred from authors to the publisher;
- A set of specifications for each department itemizing elements such as anticipated length, audience, and appropriate tone.

Where you fit in

There are limits to what an editor, even when working with an inspired Editorial Advisory Board like the one guiding *Contingencies*, can accomplish. A professional magazine, in a word, can be only as good as the input from the profession. Working in Washington, D.C., we see a gamut of professional magazines. Some could compete handily against anything for sale on a newsstand for elegance of design and quality of content; others are meager pamphlets, carrying the same tired articles every month.

We would therefore like to extend both an invitation and exhortation to SOA members to participate in the publishing of *Contingencies*. If you are interested in writing for the magazine, send us samples of your writing. If you have a finished manuscript sitting in a file somewhere, send that to us. Or if you are one of the apparently vast number of people who do not care much for writing, please contact this office anyway with an idea for a story. If it has merit, we will work with you to produce an article.

If you hear of a company or vendor that might find *Contingencies* a useful vehicle for advertisements, please give us a call about that, and we will pass the word along to our ad rep.

We hope *Contingencies* will engage and excite you and that the finished product will make you proud of your profession.

Dana H. Murphy is Editor, *Contingencies*. She is not a member of the Society.

Study manuals for SOA exams

Study manuals for Courses 110, 120, 130, 135, 140, 150, 151, 160, 162, 165, EA-1, and EA-2 are available from Actuarial Study Materials. For a complete list of manuals, write to A.S.M., P.O. Box 522, Merrick, NY 11566.

Varying the ROE target by profit center depending on risk

by Joseph H. Tan

A recent SOA regional meeting featured discussion on an age-old actuarial debate: Within the same company, should the return on equity (ROE) target vary by profit center (PC) depending upon the risk of the PC? For example, should company management (represented by the Corporate area) demand a different ROE from the Group Health line versus the Ordinary Life line?

In actuarial literature and discussions, several arguments for not varying the ROE target for various profit centers have been presented. The main argument is:

> If the allocated required surplus (RS) of the PC already reflects its associated risk, and such RS is a part of the basis for the PC's net investment income allocation and is included in the denominator of the ROE formula, the PC's ROE calculation already implicitly reflects the risk of the PC. In this case, there is no need to require higher ROE from the riskier PC, because requiring higher ROE from the riskier PC would result in double counting. A uniform ROE target should therefore be used for all PCs if RS is included in the ROE formula.

Most actuaries would agree that return should be commensurate with risk and higher return should be expected from riskier PC. Here's where the confusion arises: If RS already reflects risk and is incorporated in the ROE formula, should the ROE target still vary by PC?

Arguments against uniform ROE despite the existence of RS

This section presents arguments to show that ROE target should still vary by PC, even if the PC's RS reflects risk and is included in the PC's ROE calculation. To simplify our discussion, we assume that each profit center sells only one product, and we will use the terms – profit center and product – interchangeably.

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