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Editorial

Winners and losers

by Robin B. Leckie

For the past three years, I have had the privilege to be an associate editor of *The Actuary*. It is one of the most plum volunteer jobs available. I thank you for the opportunity to be involved.

Typically, the articles in an issue of *The Actuary* are expected to be completed at least a month and a half before the issue month. This editorial and all the articles in this issue therefore were written in early November.

Four significant, but unrelated, events have occurred in the last two weeks, each with more than passing interest to most of us. The events were:

- The U.S. election
- The Canadian constitutional referendum
- A World Series (where now the term "world" has some significance)
- The Society of Actuary's election

In each case, there were winners and losers — terms considered to be as opposite as black and white, high and low. In every case, however, the losers are in fact winners; they just happened to lose this time. The caliber and contributions of the two candidates who did not win the Society presidency (as well as the candidates included in the first ballot) place them among the top 1% of actuarial professionals. They are hardly losers. And, surely a player with the Atlanta Braves can feel proud of his accomplishments this year. And, how many individuals can we name whose service exceeds that of President Bush?

What is the message? It is to be involved. To serve. To run in elections and to be willing to lose. The real losers are those who do not get involved, who do not take chances, who do not innovate, who sit and wait and hope, hoping they will go down in history as neither a winner nor loser. Surely, it is better to be a worthy loser.

The actuarial profession needs winners and losers. We are in a world of rapid change where momentum is no longer the driving force, where our genius is needed if our organizations are to be among the surviving winners. And for them, losing is not an option. The Society of Actuaries has done wonders in the past few years in setting new directions for research and education needed for the profession to support our individual efforts. I am glad to have had the opportunity to observe this progress during these past three years. The Society continues to need volunteers in its various endeavors. How about becoming involved?

I would have preferred to title this editorial, "Winners, losers, and compromisers," but because of the risk of being misunderstood, I compromised. Compromise has a much more negative connotation than is justified, primarily because we associate compromise as the acceptance of a less than optimum solution or as a disregard for essential principles. On the other hand, leaders must obtain input and views from a broad cross section of those they serve to define the best solution to meet the situation.

A good leader will never compromise principles but may compromise some of the components to recognize the differing needs of the affected constituents. Occasionally, however, even this does not work. The revised

Canadian Constitution put to the electorate in October was a compromise to meet the needs of many of the competing interests of Canadians. It had the support of the three major federal parties, the support of all 10 provinces, of labor and business, and of aborigines. Yet, in this case, the Canadian electorate believed there was too much compromise and voted it down.

I believe actuaries are considered among the most principled of all professionals. Our integrity and adherence to the principles of our profession make us stand out and raise us to high esteem in the view of those we serve. This is what enables us to be proud and happy to be members of the profession. We should never compromise those principles. At times, however, is compromise necessary and desirable? Consider these three instances:

- Without compromising our principles in any way, can we find ways to broaden our input into the businesses in which we work? Although we have so much to offer, too often our contribution fails to be passed on in language that can be understood, too often the implications of alternatives are glossed over, and too often we don't understand other interests necessary to an optimum result.
- One of the characteristics of the current political scene is the influence of special interests at the expense of the common good. Let us in our professional endeavors be cognizant of broad principles before we stress a special interest, or worse, a personal interest.
- An important principle of the Society is the integrity and standards of the FSA. Does it then follow that universities cannot play a more significant part in our basic education? I think not. Were we right in turning down an expanded role for long-term Associates? I think not. In my opinion, in neither case would we have been compromising basic principles.

Never in my career have I ever doubted the wisdom of becoming an actuary. To be a member of this profession is to be a winner.

The Equitable cont'd

- Actual demutualization and Initial Public Offering (IPO)

The project would take two years, culminating with the IPO and formal demutualization on July 22, 1992.

Determining a method

One of our first tasks was to determine the method we would use to demutualize. The New York statute permits four methods:

1) Distribute stock to policyholders but raise no outside capital
2) Distribute stock equal to policyholder equity (a calculated amount described later) and sell enough stock to the public so the total market value of the company is equal to policyholder equity plus the amount contributed by new shareholders
3) Distribute statutory surplus to policy owners (permitted only for small companies)
4) Any other method approved by the superintendent

Method 2 was designed by the Society's task force for companies that wanted to raise capital as part of the demutualization process. Unfortunately, in practice, it has two flaws:

- The difficulty of determining how much stock to issue to ensure that the new shareholders' market value would approximate the amount they have paid for the stock
- The assumption that the market value of the company, before introducing outside capital, is at least equal to policyholders' equity

In early 1991 we determined that our policyholder equity exceeded, by a fair margin, the company's probable market value. Therefore, the only option available to the company was Method 4, because capital could not be raised under the terms of Method 1.

Our estimate of market value was based on an early 1991 actuarial appraisal (basically, adjusted net worth plus present value of future profits), plus ongoing discussions with prospective investors and their bankers.

Obtaining an investor

Negotiations with potential investors took up most of the first six months of 1991. These negotiations were very complex, because investors needed to understand all the implications on future earnings of such structures as the "closed block," described later in this article. Every week we understood a little more about the implications of the closed block, first on statutory surplus and profit and later on GAAP book value and earnings.

A third party to these negotiations was the New York Insurance Department (NYID), including their investment and actuarial advisors.

Finally, on July 18, 1991, we struck a deal with the French insurance company, Axa, with which the NYID concurred. Axa put $1 billion into The Equitable, $250 million represented by a surplus note and $750 million represented by a secured note, both of which would convert to capital upon demutualization.

Now, all we had to do was demutualize and float an IPO. The IPO was required not only to raise additional capital, but also to meet a condition in the Axa investment agreement. In the agreement, the conversion of the Axa investment to capital was dependent on an IPO that produced at least $300 million of net proceeds.

Developing the plan

Following the Axa investment, we all turned our attention to developing the demutualization plan. Twenty task forces were formed to deal with different aspects of the project. More than 100 Equitable employees devoted much of their time to the effort. Our staff was supported by outside actuarial, legal, and investment firms, as well as by advisors retained by Axa. We have identified about $150 million in total costs, not counting compensation and related expenses for our own employees. By any measure, it was a huge effort.

We met weekly, or even more often, with the NYID and their actuarial, investment, and legal advisors. The actuaries were most involved with three areas:

- Policyholder equity
- The closed block
- Special provisions for par policies not in the closed block

Policyholder equity

Although Method 4 does not mention how shares should be allocated to policyholders in exchange for their membership rights in the mutual company, we calculated policyholder equity as described in Method 2. Because our market value would not support the entire policyholder equity, policyholders would receive less than 100% of their calculated equity. This percentage depended on the market

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