SOCIETY OF ACTUARIES

ISSUE NO. 6 | OCTOBER 2004

Smaller Consulting Firm Section

THE INDEPENDENT CONSULTANT

NEWSLETTER OF THE SMALLER CONSULTING FIRM SECTION

Everyday Applications of ASOP 41

by Alan J. Stonewall

In the first article on ASOP 41 and effective actuarial communications (*The Independent Consultant*, Issue No. 5, June 2004), it was noted that there are three good reasons why you should be familiar with the guidance contained in ASOP 41:

- **It's the law—**at least for any actuary belonging to a recognized U.S. actuarial organization.
- **It's good practice.** Like all standards of practice, ASOP 41 defines generally accepted practice.
- **It covers oral as well as written communications.** Even the most mundane of everyday conversations in your office could be subject to the requirements of ASOP 41.

In this article we will take a look at the breadth of ASOP 41 to give you an idea of what kinds of communication are subject to its guidance. I will pay particular attention to what information should be included in an actuarial report and examine how ASOP 41 applies to your everyday conversations in the office.

The Breadth of ASOP 41—What it Covers

Here are three examples of actuarial communications covered by ASOP 41. For most of us, one or more of these kinds of communications occur every day:

1. **Internal oral advice.** This morning you sat down with one of the senior consultants to explain the results of the actuarial analysis you did for one of the firm's major clients. The consultant will meet with the client later this week to present your findings along with other information. Your conversation with the senior consultant is subject to ASOP 41.
2. **The e-mail client.** The CFO of a client is always busy. You have a good working relationship with her. She sends you an e-mail request to get an "idea" of what next year's policy reserve requirement will be. The e-mail response with your estimate of the reserve is subject to the requirements of ASOP 41. If there is a series of e-mails, the series of e-mails in total constitutes an actuarial communication subject to ASOP 41.
3. **The phone estimate.** You are the actuary for a small pension plan. Your client needs to know the cash contribution requirement for this year. You call the owner of the business with your determination of the required contribution. Your phone conversation with the owner is subject to ASOP 41. If there is no follow-up report, your conversation may or may not satisfy ASOP 41.

Each of the above examples demonstrates a fundamental concept built into the ASOP. Let's examine them in more detail.

(continued on page 4)

Inside...

THE INDEPENDENT CONSULTANT

Issue No. 6 | October 2004

This newsletter is free to section members. Back issues of section newsletters have been placed in the Society library, and are on the SOA Web site, *www.soa.org*. Photocopies of back issues may be requested for a nominal fee.

The purpose of the section shall be to encourage and facilitate the professional development of actuaries at smaller consulting firms through assistance with the educational, research, networking and other special needs that arise in their practice.

Newsletter Editor, Ian G. Duncan
Lotter Actuarial Partners, Inc.
15 East 26th Street | Suite 1801
New York, NY | 10010
Phone: (212) 532-6433
Fax: (212) 532-6248
E-mail: Iduncan@lotteract.com

Assistant Editor, Janet Duncan, FCAS, MAAA
XL Capital
E-mail: janet_duncan@xlinsurance.com

Society of Actuaries
475 N. Martingale Road | Suite 600
Schaumburg, IL 60173
Phone: (847) 706-3500
Fax: (847) 706-3599
Web: www.soa.org

Editor's Column

Actuaries and "Soft" Skills

by Ian Duncan

As someone who has to sell actuarial services for a living (or I don't eat), I have always thought it odd that sales, business development and communications are thought of as "soft" skills. They seem much harder to me than traditional actuarial work. So I have always been puzzled that sessions on business and personal development and communications at SOA meetings and seminars are not as well-attended as sessions on (to pick a random example) the latest technical details of international accounting standards.

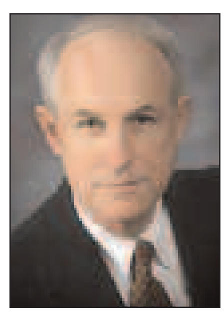
Perhaps, though, there is a wind of change blowing through actuarial circles. Three straws in this wind of change are:

- The sessions on marketing and promotion that we sponsored at the Anaheim and San Antonio meetings this year (see article elsewhere in this newsletter) were well attended. In all, 150 actuaries attended the Anaheim sessions and 75 attended the San Antonio workshops (San Antonio was a smaller meeting). I can't resist quoting one comment by a participant in San Antonio: "Excellent Session. The SOA should sponsor more such sessions."
- A suggestion was expressed by the Actuary of the Future section that we provide a business-skills resource to independent and self-employed actuaries. We will begin by posting many of the "how-to" articles from *The Independent Consultant* on the Smaller Consulting Firm Web site, where they will be accessible by topic (legal, marketing and sales, etc.). We will also post relevant contributions from other section newsletters, and indeed any good material that members make available to us.
- John Riley, SOA's Managing Director of Continuing Education, has convened a "Business Skills" task force, under the leadership of Norm Crowder, to develop training programs in communications and business skills for actuaries. John has defined the mission of the task force with some good questions:

  – What should the educational objectives and outcomes be?
  – How, generally speaking, can these be accomplished?
  – How can training be effectively distributed or accessed at low cost?
  – What recognition should be provided to graduates by the SOA?

It is appropriate, I think, that our section is well-represented on this task force by Dan Cassidy, David Ward and me. You can be sure that I will be advocating for the SOA to offer an "actuarial MBA," which gives credit for technical actuarial education and adds non-actuarial business training.

Back when I received my driver's license, the examiner said that the permit did not mean that I was any good at driving; it merely meant that I was licensed to practice driving on the public roads. If we view the FSA the same way, we will continue to learn and support the development of both technical actuarial and "soft" skills.



Ian G. Duncan, FSA, MAAA, is a partner at Lotter Actuarial Partners, Inc. in New York, N.Y., and is editor of The Independent Consultant. *He can be reached at* iduncan@lotteract.com.

Chairperson's Column

by George McCauslan

As we come to the end of our second year as a section, and as I come to the end of my two years as chairperson of the section council, I find it a good time to look back and look ahead.

In my two years as chairperson of the section, I have come to see the role of the section council as two-fold. The first is to provide direct services to our section members, either by our section alone or as a co-sponsor with another section. The second is to keep the issues and concerns of our members "in the mix" as the Society of Actuaries goes through its reorganization and looks at various changes in the structure of meetings and other activities.

Our main "service to members" has been our newsletter, *The Independent Consultant*, of which this is the sixth issue. Under the editorial leadership of Ian Duncan (Thanks, Ian), the newsletter has provided articles about business issues important to those of us in small firms, the "professional histories" of consultants in small practices, and discussion of technical issues that can yield business opportunities for the actuary in a small firm. For financial reasons, we publish the newsletter only on the SOA Web site. If you have missed any of the issues, they are all still available online.

In addition, we have sponsored sessions at both the Pension/Health Spring Meeting and the Annual Meeting. Some of these have been business-oriented; others have focused on technical issues which are important in the markets that the smaller firms tend to serve. We are also looking to prepare a Web-based resource center for those in, or planning to move to, smaller consulting firms.

At this time of change for the SOA, I believe that the work that the members of your section council have been doing on the various committees planning and coordinating these changes is equally important to our members. As the organization makes these changes, it is important that the issues and perspectives of those of us in small firms be considered. The section council as a whole is exploring how our section will fit into the new structure: which tasks make sense for us and which do not. Individual members of the section council have been working on the section/practice area restructuring for both the retirement systems and health practice areas. They have been working on the overall structure of the new associateship educational materials, planning changes to the Spring Meetings, and a new plan to provide business skills and educational materials particularly focused on the actuary. In all of these, we represent both ourselves and our SCF Section constituency.

Finally, I want to thank our one retiring section council member, Carl Shalit. Carl was one of the "from day one" folks, but other commitments led him to decline to run for re-election. The other two section council members whose terms were ending, Marcus Robertson and Ian Duncan, were eligible for re-election because they had not served a full three-year term and were re-elected—welcome back. I also want to welcome the new member of our section council, Chuck Ritzke.

I have enjoyed being the chairperson for your section for the past two years. I have one more year as a member of the section council, but someone else will be chairperson. My thanks to all who have been on the section council or who have assisted in other ways over those two years.

George McCauslan, FSA, MAAA, EA, is an independent consulting actuary in San Francisco, Calif. He is a founder and the current chairperson of the Smaller Consulting Firm Section. He can be reached at GeorgeWMcC@aol.com.

Everyday Oral Communications

Your everyday, in-office conversations with co-workers, bosses, subordinates or peers can be and often are subject to ASOP 41. Including such conversations with the scope of ASOP 41 is not an unintended consequence. There is an unambiguous logic built into the definitions in Section 2 of ASOP 41 that brings these everyday conversations within its scope.

The standard applies to an actuary issuing an *actuarial communication*. An *actuarial communication* is a written, electronic or *oral* communication to a principal.

When an actuary is working in an internal capacity and someone else is communicating the actuary's work…*the actuary's employer will generally be the principal*.

ASOP 41 recognizes that the requirements for good actuarial communications with regard to in-office conversations should not be the same as for a formal actuarial report. For example, the standard states that the form and content of an actuarial communication should be "appropriate to the particular circumstances, taking into account the intended audience." Where the intended audience is a co-worker, the appropriate content may be much less formal than what is appropriate for a written report to be presented to a client not familiar with actuarial science.

Furthermore, ASOP 41 makes it clear that it is "all of the communications, taken together" that will be evaluated to determine if an actuarial communication satisfies the standard, "even though individual conversations may not." In other words, the standard recognizes the practicalities of our profession and does not expect us to change our way of conducting business.

Nonetheless, there is one aspect related to oral communication that many of us can improve upon. That is documentation. The requirement that an actuary "should create records and other appropriate documentation supporting an actuarial communication" applies directly to oral communications. As noted above, it is not necessary that you document every conversation in great detail—the test is whether all of the related communications taken together satisfy the standard.

The Actuarial Report—What it Should Include

An actuarial report is a form of actuarial communication that is covered by ASOP 41. It is defined as a formal "written or electronic presentation…of the actuary's findings that records and communicates the actuary's methods, procedures and assumptions." It is what most of us think of when we hear the words actuarial report.

When an actuary is communicating significant actuarial findings, the actuary should communicate in writing or electronic form "unless agreed to by the principal and the actuary." Thus, oral communication of significant actuarial findings is generally not considered acceptable practice.

ASOP 41 is specific about what should be included in an actuarial report. In addition to the actuarial findings, what should be included in an actuarial report are the general requirements for any actuarial communication:

- Identification of the principal and the scope

of the engagement
- Identification of the responsible actuary
- Disclosure of any non-independence concerns
- Identification of any reliance on other sources
- Disclosure when the actuary is acting as an advocate for a principal
- Disclosure of any prescribed methods or assumptions

and specific only to an actuarial report:

- "Identification of the data, assumptions and methods used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuary's report."

The requirement that you provide enough information and clarity that another actuary is able to appraise the reasonableness of your work is fundamentally a disclosure requirement. You need not provide enough information for another actuary to duplicate your results, he or she only needs to be able to appraise the reasonableness of the results. It is my personal opinion, not directly supported by the wording in ASOP 41, that findings based on proprietary data, assumptions or methods do not require disclosure of the proprietary information in order for another actuary to test reasonableness. The test of reasonableness can be done using non-proprietary information with appropriate caveats.

An actuarial report should be included in addition to what ASOP 41 states. There are some best practice ideas you may want to incorporate into your report:

- **Include an executive summary.** Providing an executive summary is an effective way to get your important message(s) across before getting into the many details that typically accompany actuarial reporting. Frankly, I cannot imagine an actuarial report without such an executive summary.
- **Pay attention to size and order.** What you put at the front of your report will be deemed most important by the reader. What you give the most space to will be deemed more important than parts of the report getting less space. Sometimes it is unavoidable that relatively less important information gets lots of space, but there is no reason to give it prominence at the start of your report.
- **Use appendices.** One way to include adequate disclosure of details without cluttering up a report is to move supporting data and information to appendices.

Personal Responsibility

In closing, I would like to talk about personal responsibility—yours and mine. An actuary may not fall back on a firm's procedures or guidelines to explain why he or she failed to comply with ASOP 41. You alone are accountable for compliance with all standards of practice as well as each precept of the Code of Professional Conduct. Precepts 4, 5 and 6 all deal with communication.

The interpretations I have offered in this article are mine, and do not necessarily reflect those of any actuarial organization or body. Specifically, they do not reflect the opinion of the Actuarial Standards Board which does not offer supplemental interpretations of any standards it issues.

Lastly, reading this article is not a substitute for reading and understanding ASOP 41. I have covered much, but certainly not all of the guidance contained in the standard. If I have done my job well, you will have already decided to take a second look at the standard.

You alone are accountable for compliance with all standards of practice as well as each precept of the Code of Professional Conduct.

Alan J. Stonewall, FSPA, MAAA, EA, is a consulting actuary and benefits consultant with Independent Actuaries, Inc. in Beaverton, Ore. He can be reached at alan.stonewall@indact.com.

Don't go it alone!

Why Every Small Consulting Firm Should Have a Board of Advisors

by Dan Cassidy

Starting and running any small business is daunting, especially for actuaries, who through training (focused on analytics) and experience (cutting our teeth at global consulting firms), perceive the risks to be tremendous. Some actuaries never leave the comfort of a large firm. For those actuaries, whether solo or in partnership, who do make the jump, you may want to consider seeking additional support reinforcements—a board of advisors.

My primary goal for starting the board was to have a forum to discuss my business with other, more experienced business people.

Background

I run a small retirement consulting firm focused on the needs of mid-sized companies. Seven years ago, I started the firm in my home office. Since then, we have grown to six professionals (including two other actuaries). For the past four years, my firm's board of advisors has been advising me on my business.

Why establish a board?

Several reasons come to mind as I started my board including the following:

- **Open Forum**
  My primary goal for starting the board was to have a forum to discuss my business with other, more experienced business people. While working at large consulting firms in the past, I had a network of people both inside and outside the firm who provided an outlet for an open dialogue about my career. Now, with my own firm, I wanted to move beyond a quick discussion over lunch. Our board meetings provide me with a focused, business-oriented session to discuss any area of my business whether it's employees, sales, marketing, invoicing, etc.
- **Extended Network**
  Each one of my board members either owns their own business or is a senior executive. Extending my network as well as extending the network of my board members was probably the next most important reason for me to establish a board. They are more than willing to share their network with me to help me be successful. These introductions have been very helpful and are a great way to warm up a cold call. Also, some of my board members have now done business together themselves.
- **Marketing**
  My last major reason for starting the board was a focus on clients, or more accurately, how prospective clients perceived my firm. We work to differentiate ourselves from other small consulting firms and feel that a board of advisors provides another example of our commitment to this market, growing our business and being business partners.

Concerns

Some of the many important issues to consider when you start your board are:

- **Who?**
  Start with your friends, people who you know personally or have done business with in the past. Everyone I asked said yes and was honored to be asked. They ranged from the father-in-law of my best man to a private equity banker who I play squash with. Also, you will be sharing sensitive information about your business, so a level of trust is essential.

  I also asked two types of people:
  1. Industry types: those who know my business like an ERISA attorney, health and welfare broker, retirement sales executive, etc.
  2. Business types: those who didn't have the foggiest idea about my business but who knew business, like an accountant, founder of Internet company, private equity banker, etc.

Each group of people added to the conversation and provided their particular take on things.

- **How many people?**
  Initially, I erred on the side of too many people and started with eight. I did this to get both types of people (see above). But also, since this was a voluntary commitment, I knew that we would have no-shows and wanted to always have a good number of people at each meeting. Over four years, we averaged six of the eight with different people missing different meetings. This worked very well for my goal of having a sounding board for various issues and extended my network.

  In the last year, my firm has moved into a more aggressive growth phase. I felt that this would necessitate having more frequent board meetings. Thus, with my board's agreement, I have shrunk it to just three members—all of whom are business types. At the same time, the remaining members have increased their commitment to meetings, etc. In recognition of this more formal arrangement, I have instituted a small honorarium (enough for each member to take their spouse out to a fine restaurant in Boston). For the industry types, I meet with them on a regular basis for normal business and will continue to discuss my firm with them on a casual basis.
- **Willingness to share**
  Probably the most valuable members of my board were the ones who shared their thoughts—whether I agreed with them or not. These outspoken people would spark lively conversations and provide others with an opportunity to comment.
- **Liability**
  Notice that I have been using the term "board of advisors" and not "board of directors." I have structured it this way for two reasons:
  1. My board of advisors is just that, a group of people who advise my firm. We retain all decision-making functions.
  2. Since members of a board of directors have legal liability under U.S. corporate law, possible candidates for your board may be wary of being a director versus an advisor. Make sure you avoid this issue.
- **Logistics**
  We have our meetings in the evening. Since this is a volunteer activity we do not want to take away from the work day. We mingle casually over drinks to support networking among the members and then sit down for dinner and discuss my business. As a token of appreciation, I get each member a small gift (or now the honorarium).
- **How often?**
  We averaged about two meetings a year over the four years. Now, with a smaller group, we are increasing the frequency to quarterly.

Has it been worth it?

Overall, the board of advisors has been very successful. It has given me a time and place to get out from running my business day-to-day and think about longer-term goals. Oftentimes, people have very different opinions about a particular issue and it has been great to hear both sides of an argument, when I had only been thinking about one side. As with any group of people who you ask for advice, you can either use it or ignore it.

Dan Cassidy is president of Argus Consulting Inc. in Concord, Mass. He is a member of the Smaller Consulting Firm Section Council. Dan may be reached at danc@arguscl.com.

"Promoting You!"—SCF Section Sponsors Successful Workshops at Spring Meetings

by John W. Hadley

"I don't like to boast!" This was one of the first comments made at the opening of our first session in Anaheim, "Promoting You: Becoming a Self-Marketing Machine," which was attended by about 100 actuaries. This is a frequent refrain we hear when conducting workshops on how to promote yourself effectively. In fact, one FSA told us that "most actuaries instinctively abhor the whole idea of promotion because we believe that everything, including our own professional worth, should be evaluated on its merits […] we need to understand why this [self-promotion] is necessary."

We covered the soup-to-nuts techniques for being an extraordinary influencer by covering three key areas: psychology, strategy and skills.

In this two-part interactive workshop we presented not only why its vital to market yourself, but also demonstrated practical techniques for going about it in a way that doesn't make you come across like a used-car salesman! We covered the soup-to-nuts techniques for being an extraordinary influencer by covering three key areas: **psychology, strategy and skills**.

We began by asking "What is the biggest reason people fail to achieve their goals?" It boils down to them getting in their own way via their limiting beliefs. With the help of film clips from "The Matrix" the group identified the characteristics of an influencer with a resourceful psychology. What one thinks (or believes) will directly impact how they feel, which in turn impacts the actions they take (or don't take). Psychology is 80 percent of the battle when it comes to success, the other 20 percent is mechanics. We ended this section by taking the group through an exercise where they identified their limiting beliefs and replaced them with empowering ones.

Next we turned to networking techniques, working through what to do (and what not to do) to be truly effective at expanding and using your network, whether for business development, career growth or a job search. Most business owners and consultants intuitively recognize the value of the "30-second elevator pitch." Our experience is that these are frequently executed very poorly, at least in part because they are too long. We worked with the participants to create their own marketing headline: a 10- to 15-second powerful marketing message designed to generate attention, interest and a curiosity to know more about what the influencer does.

We opened the second workshop ("Promoting You: Clinching The Deal") with a discussion of the do's and don'ts of selling yourself in writing. We demonstrated this visually with specific examples, including a particularly lackluster engagement biography used by a principal at a major actuarial consulting firm (the names and details were changed to protect the innocent…or guilty!). One of the keys is to always focus on accomplishments instead of duties and to relate them to the value produced for your client.

The final portion of our workshop revealed the secrets to hitting a home run at every influencing opportunity. It has been said that "all buying decisions are based on emotion, but justified by logic." Those sellers who are the most influential appeal to both logic and emotion. This is where we often find resistance in the audience—as actuaries, we are conditioned to operate like Mr. Spock from Star Trek and ignore the emotion. Our final exercise—"the rule of three"—let participants practice a very simple technique for getting down to that emotional level, where they can create the rapport and understanding that significantly increase their influence.

The pair of back-to-back workshops seemed to deliver the intended message as shown by these comments from one of the many actuaries who stayed for both:

> "The session was very informative and thought-provoking. The interactive exercises were excellent [...] This was a great session to help actuaries promote themselves. It serves the purpose of expanding actuaries into nontraditional roles."

John W. Hadley, FSA, MAAA, provides professional career counseling for actuaries in Somerville, N.J. He can be reached at JWH@johnhadleyassociates.com.

Meet The New Kids

The Younger Actuaries section got the nod of approval at the Board of Governors June 2004 meeting. The new section was created out of the need to establish a stronger link to recently qualified and future actuaries. Led primarily by younger actuaries, the section will work to advance the actuarial profession by addressing the needs of actuaries who are in the earlier part of their careers. Among other activities, the section will serve as a venue for identification and development of future SOA leaders, will educate its members about and give them a voice in SOA activities, increase the sense of belonging to the profession and develop various programs targeted at professional advancement of younger actuaries. There is no age or credential requirement to join the section. Senior members are encouraged to join to stay in touch with the ideas and needs of the next generation of actuaries and to serve as mentors. Candidates and those early in their career are encouraged to join to link to the profession and benefit from section programs and activities that will further their professional and personal development. In order to ratify the section, 200 SOA members must sign up. Please support this cause, sign up today at: *www.soa.org/ccm/cms service/stream/asset/?asset_id=5179052&g11n*

For more information, please contact Valentina Isakina, SOA Finance Practice Area Actuary at (847) 706-3584 or *visakina@soa.org*

Smaller Consulting Firm Section to Sponsor Sessions at SOA Annual Meeting

Annual Meeting Sessions

The Society of Actuaries Annual Meeting takes place at the Marriott Marquis in New York from October 24–27. The Smaller Consulting Firm Section is co-sponsoring two sessions with the Pension Section:

1. Actuarial Nanotechnology: the Science of Small Plans

Nanotechnology, the science of building useful devices out of very small objects, is one of the hottest new technological areas. "Actuarial nanotechnology," the science of building useful plans for very small plan sponsors may not lag far behind: recent legal changes, such as the elimination of family aggregation rules and Section 415(e), as well as the 2001 tax act, have once again made defined benefit plans a viable option in this market.

Panelists discuss the unique nature of these "nanoplans" (one to five participants) with emphasis on the following areas:

- Plan design and characteristics
- Funding and valuation issues for corporations, partnerships and sole-proprietorships
- Nondiscrimination issues
- The role of life insurance in the plan, including uses, deductibility, effect on plan funding calculations, taxation, legal requirements and potential benefits for estate planning

Attendees gain an understanding of the special rules and issues that need to be taken into account when working with plans of this size.

2. A Brave New World: Accounting Standards

This session is the first session of the four-part series entitled "Redesigning The Pension System."

What is the future of accounting? Have the current standards of practice failed us? Is one global standard the answer? Should the current rules-based approach to corporate governance used in the United States continue or should the standards be principle driven? Has financial economics influenced any of the direction being taken by standard setters? This session is co-sponsored with the Financial Reporting Section and the Smaller Consulting Firm Section.

Accounting experts will discuss how accounting standards are evolving and what that might mean for pension plans and insurance companies.

Topics include:

- The concept of "fair-value" and "principle-based" accounting; what do they mean?
- Current transparency issues
- Principles on which worldwide pension accounting standards might be predicated
- Insurance accounting standards—what should change?

Participants learn about the proposals to update accounting standards.

In addition to these two technical sessions, we are sponsoring two professional development sessions:

1. The Actuary as Entrepeneur—Growing the Small Actuarial Firm

Actuaries are not generally thought of as entrepreneurial. Many actuaries establish and operate successful small businesses, and a few grow start-ups into large corporations. How do they do it? This session features some of the successful actuarial entrepreneurs.

Panelists discuss:

- Building a successful actuarial business
- Finding, hiring and retaining talent
- Raising capital
- Partnering, merging and acquiring other companies.

Presenters are: Dan Cox, former CEO of Life of Virginia and former head of the healthcare consulting practice of Aon, currently at Chicago Consulting Actuaries, Inc. Dave Florian, founder of Pivot, currently director of reinsurance at Wachovia Bank, (see article elsewhere in this newsletter) and Mike Miele, founder of CDMS, which he sold to Landacorp, Inc. in 2000 (see *Independent Consultant*, Issue 1, 2002).

2. Selling Skills for Actuaries: Overcome the Fear of Making Sales Calls

Every independent consultant dreads doing what is probably the key to their success—making sales calls. The result: procrastination, avoidance, no new clients and no new money!
Dave Miller is an actuary and professional sales coach. He will include some of the material he is presenting at the spring meetings. In this workshop, he will take participants through the Steps to Blast through Sales Call Reluctance.

1. Identify and evaluate existing beliefs and rules.
2. Destroy those beliefs!
3. Engage an alternative empowering belief.
4. Take action now!!

Defined Benefit Plans in Canada—Small Can Be Successful

by David C. Hart

... defined-benefit plans are still preferred by many government workers, union groups and senior management groups.

The period from 1970-90 could probably be called the golden era for defined benefit pension plans in Canada. At the beginning of that period, most actuaries still worked in insurance companies, but by the end of that period almost half of Canadian actuaries worked in benefit consulting firms or for the various government pension regulators.

The federal and provincial governments kept churning out pension and tax legislation, which as a group could easily be subtitled "The Actuaries Full Employment Acts." Although the Federal Income Tax Act regulated pensions and restricted the amount of contributions to a pension fund, pension legislation, which protected the pension rights of the plan members, fell under individual provincial legislation or federal legislation for specific national industries such as banking, transportation and communications.

Alas, death, taxes and change are the only true social constants and change has led to the restriction (but not complete demise) of the defined benefit plans. A risk-averse company philosophy has led many companies to rethink their retirement strategies and to change their retirement plans from defined benefit to defined contribution. Younger employees who do not expect to remain with the same employer during their whole working lifetime usually welcome such a change.

However, certain employee groups such as older workers, employees who expect to remain with an employer until retirement and high-income-earning decision-makers usually prefer the defined benefit plan. For this reason, defined benefit plans are still preferred by many government workers, union groups and senior management groups.

As in any other country, national tax policy dictates the form of individual retirement savings and employer retirement plans. Canadian tax policy has always provided a certain amount of tax relief for retirement savings for both an individual registered retirement savings plan (RRSP) and a company-sponsored registered pension plan (RPP).

Since 1991, federal tax policy has been coordinated between individual and company registered plans so that the amount of benefit provided by the company RPP will lower an individual's maximum contribution to an RRSP.

The Canadian tax policy currently provides relatively the same treatment for RRSP and RPP plans. The contributions provide a deduction from current taxable income, the investment earnings are not taxed while they remain in the fund and payments from the fund are taxable income for the individual in the year received as retirement payments out of the fund. In addition, a company can pay the administration expenses of the RPP and deduct them as a normal business expense.

Prior to 2003, the maximum annual defined benefit pension allowed at retirement for each year of service (2 percent of final average earnings to a maximum of $1,722.22) had remained relatively unchanged for the past 20 years.

The tax policy was changed in 2003 to increase the maximum annual pension accrual for a defined benefit pension plan from $1,722.22 in 2003 to $1,833.33 in 2004, $2,000.00 in 2005 and increasing each year thereafter by increases in the average industrial wage index. Maximum contributions to a defined contribution pension plan increase from $15,500 in 2003 to $16,500 in 2004, $18,000 in 2005 and increasing each year thereafter according to increases in the average industrial wage index. Maximum contributions to an individual RRSP will lag the defined contribution (DC) pension plan contributions by one year.

Although overall membership in defined benefit pension plans continues to decline, a niche market is currently developing for designated plans, particularly individual pension plans (IPP). An IPP is a designated plan with only one member; however, the member is usually given the full right to any surplus and may also be allowed to direct the investment strategy. In some cases an IPP may have two members who are spouses and who are both major shareholders and employees of their company.

There are three main reasons for the current increase in new IPPs. First, there is an emerging market of small corporations, which, after 10 or 20 years of operation, are providing significant revenue to the original owners who are concerned about tax-effective saving for retirement. Some of these small businesses are "mom and pop" operations with the two spouses jointly controlling the operation. Second, many medical professionals across Canada, who in the past could only contribute to an individual RRSP, will now be allowed to participate in a company RPP. Third, the recent tax changes in 2003 increase the value of establishing a defined benefit RPP.

The best candidate for an IPP is a highly compensated employee who has previously relied on RRSPs for retirement savings. An individual with earnings in excess of $90,000 can currently contribute up to $15,500 for the year into a RRSP. However, a company can currently contribute to an IPP the amount of $15,700, $18,900, $22,800 and $26,600 respectively for an employee age 35, 45, 55 and 65. These contributions are calculated using a restrictive set of assumptions prescribed in the Income Tax Act and regulations to determine the maximum contribution allowed for such an executive pension plan. The company can also pay and deduct any plan administration expenses.

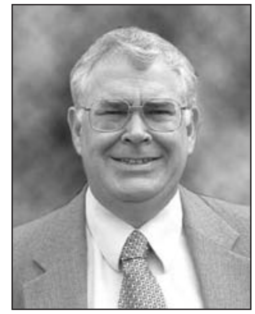
The IPP can also provide a past service benefit, usually back to 1991, while the member was an employee of the company. In that case an amount, which is essentially the contributions originally paid to the individual's RRSP, must be transferred from the RRSP to the IPP. The company must make up any shortfall in the initial liability, which would be approximately $8,000 per year of past service for a member aged 60.

The target market for an actuary's IPP business is normally a financial planner and sometimes an accountant. The actuarial consulting firm will usually deal with the IPP member through the financial planner or accountant and must be prepared to accept that role of secondary advisor.

The IPP market can certainly provide a reasonably lucrative line of business for a small actuarial consulting firm. However, the fees are constrained as a result of the size of the plan. In addition, the work requires IPP tax rules expertise, attention to detail and a considerable amount of administration work to set up the plan and provide the annual maintenance.

To succeed in the IPP market, a small actuarial consulting firm must develop the systems to handle a large number of cases, standardized documents and administration procedures, be able to cope with the annual surge of time-constrained work during certain periods of the year and target as broad a base of financial planners and accountants as possible. On paper, it sounds pretty reasonable. In practice, it takes a lot of work.

Glossary of Canadian pension terminology:
Designated Plan: an arrangement that covers a small number of employees or primarily highly paid employees. IPPs are examples of designated plans.
Registered Plans: Qualified plans (under the income tax act).
Deductible Contributions: Income deferrals.



David C. Hart, FSA, FCIA, is a consulting actuary and president of Hart Actuarial Consulting Ltd. in Mississauga, Ontario, Canada and a member of the Smaller Consulting Firm Section Council. He can be reached at dhart@an-actual-actuary.com.

Using Contractors to Create a Project Team: Legal Issues to Watch

by David S. Rintoul

You've landed a great contract, a contract so great that you and your current staff can't do all the work yourselves. You know just the person to do the number crunching so you can work on the strategic direction and client management. Before you call her, keep the following issues in mind, and there will be a better chance that you and the technician realize all the potential benefits the contract offers. Each of the issues below is potentially complex, and will be discussed in more detail in future articles. This should give you an idea, though, of the issues you need to consider even before you consult with your lawyer. For more perspective on many of these issues, consult my prior article on client agreements at *http://library.soa.org/library-pdf/SCF0406.pdf* on page 9 of that issue.

Intellectual Property (IP) Issues

You need to consider IP issues to protect your own intellectual property and to make sure you are buying the rights to the contractor's work that will allow you to fulfill your commitments to the client. Make sure the contractor acknowledges that any materials he will access during the assignment are your intellectual property, and that he agrees to keep it confidential. If the contractor's knowledge of the information would give him or her a leg up in competing with you, then the agreement should contain a tightly drafted non-compete limiting the contractor's ability to offer a competing product or service for six months to a year. The contract should provide that any work by the contractor is "work for hire," which means that his work product belongs to you. If the contractor retains ownership rights in his work product, then the agreement has to provide that he grants you an irrevocable fully paid license to sell the IP as a part of your product and service and to grant similar licenses to your customers.

Non-Competition / Non-Solicitation

You also want to make sure that your contractor does not divert the client or other future business opportunities from you in the future. These agreements can take two forms: a non-solicitation clause that restricts the contractor's right to do business with a specific client, or a non-compete clause, that restricts the contractor's right to do business in a certain sector in a certain geographical area for a period of time. A non-solicitation clause should provide that the contractor may not do any business with the client for six months to a year. Areas of flexibility are making the non-solicitation apply only to a certain division, if the client is large, or allowing the contractor to provide non-competitive services to the client. Allowing the latter, however, risks diluting your contacts with the client. If you become aware of an opportunity to provide service to the client that is not in your area, you probably want to reserve the ability to either subcontract out the work, or at least be able to hand a plum assignment to someone who might be able to return the favor in the future.

There are two theories in drafting non-compete agreements: either draft a very broad non-compete in hopes that it will be enforced to the full extent the law allows, or narrowly draft the non-compete specifically to protect your material interests. In the context of dealing with a fellow professional in a short-term assignment, the latter theory is preferable. You do not want your profit on the deal eaten up in renegotiating a draconian non-compete to reach a result that will be acceptable to your contractor. Spend some time thinking about how to define the business you want to protect, and the actual geographical area in which you do business. You will end up with an agreement that is less likely to sour the relationship with your contractor, while making it more likely that a court will enforce it.

Employee vs. Contractor

One of the most important issues to address in the agreement, especially one that is longer term, is to make sure that the contractor will not be considered an employee. Employee status means potential liability for unemployment, worker's compensation, employment taxes and employee benefits such health insurance if you have a group plan. So long as you only have one employee, you generally don't have to worry about statutory employment laws like discrimination and employee-benefit statutes. There are 20 factors that go into determining whether someone is an employee or a contractor. The following Web site has a good list:

http://www.bsrvm.berkeley.edu/procure/purguide/20lawfac.html.

One factor not listed is that a contractor is less likely to be considered to be an employee if payment is contingent on the payment to the prime contractor. All the factors do not have to be present, but you should structure the transaction and have the agreement contain acknowledgments that establish as many as possible. These factors are weighed differently in different situations, and it can be quite difficult to determine ahead of time how a court or the Department of Labor will rule in a specific instance. Keep these issues in mind. Try to address as many as you can, and you will probably be okay.

Payment Terms

If the contract is hourly, it is appropriate to pay the contractor less than the rate you are billing to your client. Like a placement firm, you should be compensated for the benefit the contractor is getting from your sales and marketing expenses. One of the more controversial issues with payment terms is whether the contractor gets paid only when you get paid on the prime contract. Guaranteeing payment does increase the chance for the contractor to be classified as an employee, so if it is a close case, you may want to insist on payment to the contractor depending on your getting paid. One way to address the issue is to separate the compensation into two parts: one portion paid hourly and guaranteed and the rest being some form of profit sharing paid upon completion of the project. If you do have some type of profit sharing, make sure the agreement provides that profit is determined after direct and indirect expenses on the contract are deducted, including some portion of your fixed overhead.

With attention to a few of the legal issues noted here, you can successfully use contractors to create just the right virtual firm to handle a wide variety of projects that you could not handle on your own, but without shouldering the burdens of full-time employment.

David S. Rintoul represents many independent consultants in addressing the legal and business issues arising from a professional consulting practice. Feel free to send any legal or business questions or comments that you confront in your practice to drintoul@bpslawyers.com, and they may be the subject of a future column. ©2004 David S. Rintoul.

One of the most important issues to address in the agreement, especially one that is longer term, is to make sure that the contractor will not be considered an employee.

David S. Rintoul practices with the firm of Brown, Paindiris & Scott in Glastonbury Conn. He can be reached at drintoul@bpslawyers.com.

Insurance Entrepreneur: David Florian

Like many actuaries, David Florian was dissatisfied with the way that insurance products were created, administered and sold. Unlike most actuaries, however, David's impatience led him to start a company dedicated to changing the marketing and delivery of insurance.

David and his partner, Lou Hensley, saw opportunity where others saw only old-fashioned, inefficient business practices.

David spent the early part of his career at Conseco, a company known for its entrepreneurship and for causing waves in the insurance industry (though that is a story for another day). From Conseco, he was hired by Midland Life Insurance Company in Columbus, Ohio. Midland specialized in inexpensive term insurance, a highly competitive market. As he got to see the market in action, David noticed that after mortality, the cost of distributing the company's products was their greatest single expense. Mortality costs have been declining for years, but administrative expenses have stayed flat or increased, as old-fashioned business practices proved hard to change.

In the mid-1990s, the Internet became the catalyst for changing the distribution in many different markets. Even insurance distribution was affected. "Insurance supermarkets," like Insweb and Quotesmith began to offer sellers of standard insurance products like term insurance the opportunity to reach a large, previously underserved market of insurance consumers. Internet distribution of insurance, as with so many products, was probably oversold and overhyped. Many companies that were started in that era (both insurance distributors and others) have disappeared along with other dot-coms, or changed their business model.

David and his partner, Lou Hensley, saw opportunity where others saw only old-fashioned, inefficient business practices. In June 1998 they formed Pivot, a distributor for low-cost term insurance, to appeal to those price-sensitive buyers who wanted to go directly to the "factory" to get their insurance. David wanted to make it easy for the consumer to buy. His work in life insurance had convinced him that insurance companies (and actuaries) make it hard for consumers to buy and for agents to sell. Unlike Quotesmith and Insweb, companies that offered many, even hundreds, of companies' products, Pivot focused on a small number of competitive companies that the owners got to know quite well. That enabled Pivot to offer service to applicants who may have had a condition that would be rated by some companies but could be accepted on more favorable terms by a company with a more favorable view of that condition.

Although Pivot built an Internet site to drive sales, the selling strategy was not Internet focused. Sales were not closed on the Internet. Instead, the Web was an education, data-gathering and quoting tool, driving the applicant to speak with an agent. To accomplish this, David and Lou had to establish an insurance sales call center from scratch, including hiring, purchasing telephone equipment and obtaining state licenses to sell insurance.

The cost of attracting customers, however, was high relative to the margins in low-cost term insurance. This caused David to seek higher-margin opportunities and to branch out into permanent insurance, property/casualty insurance and annuities, and to market the services of Pivot to other insurance companies. One niche market was follow-up sales to prospects who had rejected guaranteed issue offers, but who could be attracted by lower-cost, underwritten insurance. The change in Pivot strategy resulted in Midland Life selling Pivot to I-Life (now Bankrate.com). I-Life was assembling the components to be a provider of information and content to prospective insurance buyers, with the objective of converting the prospects with actual sales of insurance products. The economics of this strategy, like that of other providers of content on the Web, proved unsustainable and Pivot was sold to First Union Bank (now Wachovia), where it continues to be an important component of the bank's financial product sales strategy.

With the sale to First Union, Pivot gained more experienced management, and David found new challenges heading up a start-up reinsurance operation within Wachovia, where he continues to work on the problem of increased efficiency in insurance distribution. "We haven't yet developed the right life insurance product for the Internet" he says.

David Florian

David's lessons learned:

David and his partner founded and sold a successful company. Like most entrepreneurs he learned a number of lessons from his experience, lessons that he is applying in his new position as head of a start-up reinsurance subsidiary of the bank to which he sold Pivot.

Focus: partly because of the external market environment, Pivot lost its focus on its original mission (to be an efficient distributor of inexpensive term insurance). Revenue needs drove the company to branch into distributing many products to many markets. In turn this led to a lack of focus on one of the critical success factors for Pivot: the need to simplify the application and issue process and to drive out costs. (It did not help to go through multiple changes in ownership and strategic direction in this time, either.)

Experience: the Pivot team (like that of many dot-com start-ups) was young, enthusiastic and hard working. Like many entrepreneurs, David realized that as the business grew and became more complicated he needed managers with experience in handling people and making business decisions. "We needed more people with operations experience and fewer visionaries," David says.

Realistic Planning: David's advice regarding planning for a start-up company is to develop a conservative business plan, then to add 50 percent to your time estimates, and 100 percent to your cost estimates. "Time and resources are better invested in showing your backers that you know what you are doing, and convincing them that your (conservative) plan is realistic. It is easier to tell your owners that you are ahead of plan than to explain why you are behind plan."

PIMA Announces New Award

The Professional Insurance Marketing Association (PIMA) announced it has established a new award called the **Product and Process Innovative Marketing Award—or P2IMA**.

The award, a joint venture between PIMA and the Society of Actuaries' (SOA) Nontraditional Marketing Section, addresses a challenge put forth by Jay Jaffe, FSA, MAAA, who is a member of both organizations. "Product and process innovation are the heart of insurance marketing success," said Jaffe, president of Actuarial Enterprises, Ltd. "The P2IMA program promises to keep PIMA and SOA Nontraditional Marketing Section members informed about new ideas and help them communicate knowledge about their new product or process concepts to other members."

PIMA's Product and Process Innovative Marketing Award competition, which is co-sponsored by SOA's Nontraditional Marketing Section, is open to all PIMA and SOA Nontraditional Marketing Section members. Entries will be judged equally on three critical elements: originality, salability and profitability. The best entries will be showcased in the association's e-newsletter, "PIMA in the Loop" and at the MarkeTTech℠ Symposium from October 24-26, 2004 in Alexandria, Va.

The award will be presented at PIMA's Annual Meeting on February 10-13, 2005 at the Loews Ventana Canyon in Tucson, Ariz. This year's judges are Don Neal, chief marketing officer, Marsh Affinity Services; Nancy Manning, associate actuary, Aegon Direct Marketing Services; and Jay Jaffe, president, Actuarial Enterprises, Ltd.

First-year eligibility is for any new product or service that has been introduced on or after Jan. 1, 2001. Products of any type may be submitted, including both insurance and non-insurance products, as long as a PIMA or SOA Nontraditional Marketing Section member is involved. A new process is one that helps to improve the marketing of an existing or new product.

Entries should include an appropriate description of the product, the features of the new product or process, marketing or other materials used to distribute the product, a policy form or other formal description of benefits provided, the premium rate or cost structure, and any other materials that will help in the review.

Entry details and a $95 fee (per entry) are due Oct. 15, 2004 to Mr. Ralph Gill, Professional Insurance Marketing Association, Attention: P2IMA, 6300 Ridglea Place, Suite 1008, Fort Worth, TX 76116. For more information about the PIMA Product and Process Innovative Marketing Award, call (817) 569-PIMA.

The Professional Insurance Marketing Association (PIMA), celebrating its 30th anniversary year and still growing, is the nation's premier association for insurance marketers and consists of third-party broker administrators, insurance carriers and allied business partners involved in the direct marketing of insurance products. Formed in 1975 as a not-for-profit organization, PIMA provides educational conferences, legislative updates, networking opportunities, publications and manuals to all those whose primary business is insurance marketing.

For information on the award and an application form, visit the Nontraditional Marketing Web site at *http://www.soa.org/ccm/content/?categoryID=305005*. Information is also available at the PIMA Web site: *www.pima-assn.org* or call (817) 569-PIMA.

20 August 2004

Dear Consulting Actuary,

2004 IACA Conference: Sydney

We hope you can attend the conference "21st Century Risks and Rewards for Actuaries", to be held from October 31 to November 5, 2004. The conference is being sponsored by the **International Association of Consulting Actuaries (IACA), the new Pensions, Benefits and Social Security Section of the International Actuarial Association (PBSS) and the Institute of Actuaries of Australia (IAAust).** The Colloquium is at the Shangri-la Hotel in the Rocks area of Sydney, next to Sydney Harbour and close to Circular Quay, the Sydney Opera House and Sydney Harbour Bridge.

This is the premier event on the 2004 calendar of IACA, PBSS and IAAust and will bring together consulting actuaries, pensions and social security actuaries, health actuaries and many actuaries interested in the professional issues confronting the profession at present. We expect that many actuaries who are the thought leaders of the profession will attend this colloquium.

The key components of the program are:

For IACA: Monday 1st November and Wednesday 3rd November

- Actuarial consulting opportunities in the 21st century
- Professional practice issues: litigation avoidance, actuarial ethics and corporate governance
- New markets and new opportunities for actuarial expertise.

For PBSS: Wednesday and Thursday 3rd and 4th November

- Social Security reform issues
- Accounting for pension costs
- Managing the pay-out phase of defined contribution plans.
- Pension scheme impact on investment markets and the implications on funding levels.
- The impact of ageing populations and strategies for delaying retirements.

For IAAust: Friday 5th November

- Financing health services in the 21st Century and intergenerational issues.
- New actuarial work in health workforce management, capital markets and resource planning.

Delegates may enjoy a day of Australian culture on Melbourne Cup day, Tuesday November 2nd on a tour to Greg Norman's vintage golf course in the Hunter Valley, the wine growing area near Sydney. There will be a Melbourne Cup lunch and this famous horse race will be seen on a big screen after golf and/or wine-tasting.

Details of the conference are available from Clare Zuber of the institute of Actuaries of Australia on +61 2 9239 6113 or via email Clare.Zuber@actuaries.asn.au and also on the web site http://www.actuaries.asn.au/PublicSite/events/iacacolloquiumprogram.htm.

We would also like to take this opportunity to announce the 2004 annual meeting of the Conference of Consulting Actuaries, to be held at the Fairmont Orchid, Kohala Coast, Hawaii, October 17-20, 2004. The CCA extends a friendly Aloha to IACA members who might wish to visit Hawaii en route to the IACA meeting in Sydney later in November.

Yours sincerely

Brent Walker	**Graham Rogers**	**Chris Daykin**
Chairman of IACA	**President IAAust**	**Chairman PBSS**