



SOCIETY OF ACTUARIES

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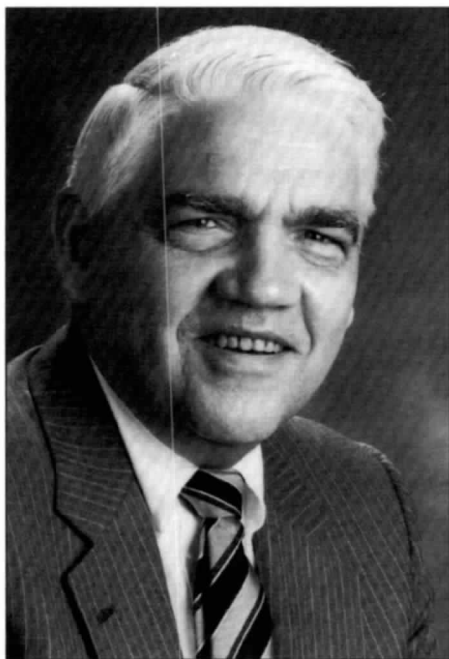
# The Actuary

1993-94 SOCIETY OF ACTUARIES YEAR IN REVIEW



**Our Foundation Is Our Future**

# Annual treasurer's report



by Harry D. Garber  
Vice-President, Secretary and Treasurer  
Society of Actuaries, 1993-94

The Society of Actuaries is in a sound financial position. The results for the fiscal year ended July 31, 1994 (FY 1994) were as follows:

	Amounts (in \$1000's)
Income	\$ 12,995
Operating Expenses	<u>12,944</u>
Net Operating Income	\$ 51
Non-operating Income	<u>123</u>
Increase in Member Equity	\$ 174
Member Equity as of July 31, 1994	\$ 6,318

The non-operating income of \$123,000 represents the excess of a gain of \$770,000 from the negotiation of a new lease for the Society's office over the \$500,000 contributed as seed money to the SOA Foundation and a charge of \$147,000 to change our

management accounting for research projects from an "as paid" basis to a "committed" basis. The member equity of \$6.318 million represents 43.8% of the budgeted expenses for the current fiscal year, a level that is consistent with those of other well-operated professional organizations.

The complete Financial Statements and the Independent Auditor's Report of Selden, Fox and Associates, Ltd., will be published in the *Transactions of the Society of Actuaries*.

We have been able to maintain member dues levels while building member equity in recent years, principally because of a surge in the number of persons taking examinations. The cost of developing and grading examinations is largely fixed so that the increase in the number of examinations given produced a significant growth in net income. This surge in examinations given is now subsiding and, with it, the net income from the basic education and examination activities is decreasing. At the same time, the SOA commitment to research is requiring ever-increasing expenditures for basic research studies. As a result, the future will require more exacting financial management, possibly including some downsizing and restructuring of the Society's operations.

For the current fiscal year (FY 1995), the SOA has established a budget with revenues and expenditures of about \$14.2 million and net operating income of about \$21,000. This delicately balanced budget was achieved through a combination of revenue increases and expenditure reductions. Among the revenue increases was an increase in member dues of \$20 (\$10 for ASAs who reached the ASA level less than five years ago). This is the first increase in member dues since 1990.

During the review and consideration of the SOA Budget for FY 1995, it became clear to the Committee on Financial Affairs that SOA expenses are

growing faster than revenue. For example, in the last three years, operating income has grown by 2.2% per year, while operating expenditures have increased 5.3% per year and operating income has decreased from more than \$1 million in FY 1991 to about \$50,000 in FY 1994. Although we were able to achieve a balanced budget for FY 1995, large and growing deficits are projected for future years. These prospective deficits could be addressed year by year, as we have in the past, but this approach would entail a considerable risk that short-term actions taken to eliminate a prospective deficit for the next fiscal year could prove harmful to the organization in the long-term.

To assure that budgets would be developed in the long-term interests of the Society, the Committee on Financial Affairs recommended, and the Board of Governors approved at its October meeting, an approach to budget planning and development. This approach involves a five-year fiscal cycle and the enhancement of the budget process to prepare separate plans and goals for each of the several segments of SOA operations, based on targeted financial results.

The four activities to be recognized as separate segments for financial management and budgeting purposes are: (a) basic education and examinations; (b) continuing education; (c) research; and (d) member services, general overhead, and other activities. The targeted financial goal for the education and examinations activity is to break even, after contributing 10% of revenue to research and 5% of revenue to cover general overhead costs. The target for continuing education activity is to break even, after contributing 5% of revenue to cover general overhead activities. The target for research activity is to break even, taking into account the contribution from the basic education

(continued on page 10)



## Presidential address (continued)

of a paradigm shift. The old paradigm, which is now 150 years old, is based on single point estimates of risk using mean values. This structure worked quite well when the distribution of risk was clustered around the mean.

However, this required an environment of low risk and predictable variables. Now the environment requires that the paradigm encompass broader ranges of risk and wider dispersion of risk variables. Instead of just studying the first moment of the distribution function, we must now focus on the second and maybe the third moments. We have used crude approximations of the deviation from the mean by using scenario testing. We are evolving to more sophisticated models to describe risk, but much remains to be done. As an aside, many of our customers still want single point estimates of risk, even when that doesn't make sense. This makes the job of communicating the consequence of risk even more difficult.

Despite this chaotic environment and the changing paradigms, I still think it is worth the effort to document the paradigms. This defines the

uniqueness of our work. It also provides the language and currency upon which to trade the ideas bubbling up in this crazy, changing world.

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***We earned respect by focusing on doing the right things, as guided by the principles of our science.***

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### Character of an actuary

I would like to close with my view of the true character of the actuary. In many of my speeches and writings, I have characterized actuaries as the scientists, architects, and engineers for financial security systems. This makes the definition of an actuary perfectly clear for me. We are scientists — applied scientists who use rigorous mathematical models to describe, analyze, and quantify risk. We are architects — financial architects who design financial security systems to

provide payment of benefits when needed. We are engineers — social engineers who can build and maintain financial security systems to withstand the stress of economic ups and downs. This is our unique heritage, and it is immensely valuable. Some would like to shed our stereotype as nerdy number crunchers, and I agree with that objective. But, we cannot forsake our core competencies in the process. We must remember that the value we have is the skill and ability to do analyses that no one else can. This will always be our primary strength.

I am left with a poignant memory from my international travels this year. Everywhere I went, I found the Society of Actuaries held in the highest regard. This reputation holds for the entire profession as well. It makes me proud to be an actuary.

Would it be too bold to say that we are one of the most respected professions in the world? We earned this respect by focusing on doing the right thing, as guided by the principles of our science. Yes, I believe actuarial science is the foundation of our future.

## Annual treasurer's report (continued)

and examinations activity and 25% of member dues. The target for member services, etc., activity is the desired addition to member equity, taking into account the contributions to cover general overhead costs, 75% of member dues, and the investment income earned.

We believe that the new financial budgeting and reporting structure will provide a better set of tools for the planning and management of the Society's finances in the period of restructuring that lies ahead. We recognize, however, that while this structure is appropriate for today and the foreseeable future, circumstances will change over time. For example, increased competition may not permit us to achieve our program and net income goals for the basic education

activity; new income-producing or service activities may arise; the SOA Foundation may significantly reduce the research funding burden on the SOA. We believe that the new financial approach can be adapted to any such changes in circumstances.

The restructuring of the Society's operations will require several years. To assist in the planning and execution of the restructuring, the Board of Governors has agreed that the SOA should operate on a break-even basis over the five-year planning period. If a break-even operating result is achieved for this period, the resulting member equity at the end of FY 2000 would still constitute more than 25% of the expenses for the following fiscal year.

In addition to the concentration on the Society's financial management and

reporting structure, the Committee on Financial Affairs has, over the past two years, reviewed the policies governing the investment of the Society's assets. As a result of this review, the Board of Governors adopted revised investment policies and guidelines at its June meeting. Under the revised policies and guidelines, the great bulk of the assets not required for cash management purposes will be invested in a laddered portfolio of Federal government bonds with five year maturities at the time of purchase. The remainder of the funds will be invested over a period of three years in U.S. and Canadian common stock index-type funds. We believe the new policies will provide greater returns and cash flows with minimal added risk.