Ten Predictions for Risk Management

by James Lam

Editor’s Note: This article is an excerpt from the author’s new book, “Enterprise Risk Management – From Incentives to Controls,” published by Wiley Finance.

The future for risk management is bright. Regulators and managers are recognizing the importance of risk management as a way to minimize losses and improve business performance. Risk professionals are moving up in the business world, both in terms of organizational level and compensation. While there are many remaining challenges, one cannot help but think that the best is yet to come for the risk management profession. Against this backdrop, I will look into my crystal ball and make 10 predictions of how risk management will change over the next decade.

1. Enterprise Risk Management (ERM) will become the industry standard for risk management.

ERM will continue to gain acceptance as the best way to ensure that a firm’s internal and external resources work efficiently and effectively in optimizing its risk/return profile. New financial disasters will continue to highlight the pitfalls of the traditional “silo” approach to risk management. External stakeholders will continue to hold the board of directors and senior management responsible for risk oversight and demand an increasing level of risk transparency. More importantly, leaders in ERM will continue to produce more consistent business results over various economic cycles and weather market stresses better than their competitors. Their successes will gain attention and other companies will follow. These trends, coupled with a stock market that is increasingly unforgiving of negative earnings surprises, will compel businesses in all industries to adopt a much more integrated approach to measuring and managing enterprise-wide risks.

2. A Chief Risk Officer (CRO) will become prevalent in risk intensive businesses.

The rise of the CRO goes hand-in-hand with the trend towards enterprise risk management. Risk management is a key driver of success for financial institutions, energy firms, asset management firms and non-financial corporations. Many market leaders in these industries have already created the position of a CRO. Others will follow suit. Companies without a CRO are faced with three perplexing questions: First, are we comfortable with diffused risk responsibilities, and if not, who is the de facto CRO—the CEO or CFO? Second, are we employing part-time efforts sufficient to manage risk in an increasingly volatile business environment? Finally, is our company able to attract and retain high caliber risk professionals if a CRO career track is not available to them? For an increasing number of companies, the logical resolution of these questions will be the appointment of a CRO and the dedication of resources to implement an ERM program.

continued on page 4
The career opportunities of an individual actuary are dependent upon the skills he or she has obtained, how well they are applied and how they grow over time. So if you’re already an actuary, you have developed your skill level and ability to apply those skills through your actuarial upbringing. Your professional future is now dependent upon you. In contrast, the survival of the actuarial profession is dependent upon the perceived value of actuaries as a group to business leaders, and whether those business leaders believe that the current state of actuarial training (exam and experience-based) will produce professionals with skills as valuable as those who currently serve their firms.

By expanding into some nontraditional areas over the past several years, I’m certain that I have enhanced my career potential as an individual. However, working outside core actuarial responsibilities, I may not have noticed the need for, or been active enough in, defending the core role of actuaries within my organization. I have only recently realized that I need to spend time and energy not only on my own career, but on enhancing the perception and understanding of core actuarial work and skills within my organization.

If you are working in an organization that employs enough actuaries to have an actuarial program, what is your program working towards? Is it only about exam support and salary studies? Is it about developing the careers of individual actuaries? Is it about defending the core responsibilities of actuaries? What can you do to ensure that it is about all of these things?

This issue of our newsletter includes a balance of defending the core and creating the future for actuaries. Adrian Pask deals with a perennial issue for actuaries—communication, which when well done, can enhance the perception of actuaries throughout the organization, whether in core roles or nontraditional ones. Teresa Winer’s article addresses actuarial opportunities in the viatical industry—what is more core to an actuary’s work than the life contingencies underlying this industry? James Lam, a non-actuary, considers an arena actuaries are well suited to enter—risk management. Finally, Sudha Shenoy’s article provides good career advice for actuaries.

Take note of all of the possibilities to enhance the reputation and role of the actuary—internal and external, traditional and nontraditional. And then choose how you will act to make a difference.
The Actuary of the Future Section Council has been busy this year. I would like to share a few of our accomplishments and keep you informed about some ongoing developments.

This year we have really attempted to work closely with other sections and hope to do even more next year. We have sponsored sessions that are of current importance to the profession by working closely with The Management and Personal Development Section and other sections. We sponsored “Managing Your Career Within a Traditional Setting,” and “The Future of Our Profession: Critical Skills Needed For Future Success.” The annual program will have “The Actuary at Risk” & “Career Pioneer Program” sessions sponsored by our section. We have also sponsored hot breakfast sessions providing updates on our accomplishments.

We continue to work on strategic initiatives. Dorn Swerdlin, our liaison with the Strategic Planning Committee, is working on the group looking at the value of the credentials.

The May 2003 Council of Section Chairpersons Meeting focused on many key issues. A Governance Task Force established earlier is looking at important issues such as voting participation and helping members become more effective leaders. Recognizing that the SOA sections have been successful, the task force is now examining ways in which the success, vitality, and energy of the sections might be used to enhance the SOA and serve its members. The Implementation Task Force on Sections and Practice Areas in Phase I is charged with looking at more coordination between the practice areas and sections and also a clearer definition of the roles and responsibilities as well.

**Critical Skills Education**

We sponsored a session at the SOA Spring meeting on the critical skills needed for success. This session addressed the business savvy skills that the SOA survey identified as critical to our future success. The outcome highlights, amongst other issues, a critical need for actuaries to develop and refine business savvy skills, which include:

- Business Communications
- Business Acumen
- Self-Development

- Relating to Others
- Leading People
- Personal Courage

We are continuing to work on developing the Web cast but have had to postpone from rolling it out this fall. We are waiting for additional research to be completed by the Strategic Planning Committee so that we can move forward with a clearer sense of direction and definition on these skills. Meanwhile, we should all work at getting better at these skills each day using the tools that we have at our disposal. We hope to create a list of resources and tips on our Web site for improving business savvy skills. We would be very happy to hear your thoughts and ideas on this subject as well. You can also look forward to sessions on these topics sponsored by our section in the future.

**New Opportunities in Risk Management**

As you already know, we now have a new section on risk management. I urge you to join this section if you have not done so already. One of the section’s goals is to advance professional recognition and career opportunities for actuaries in the arena of risk management. This should provide new opportunities for actuaries such as the Chief Risk Actuary (CRO) role as well as other opportunities in Enterprise Risk Management.

Last month in Washington D.C., I attended the Risk Management Symposium jointly sponsored by the SOA and the Casualty Actuarial Society. I also attended to the CRO Round Table discussion prior to the symposium. The Symposium was well attended and was very informative.

Actuaries can play a critical role, whether it be in health care, pensions, reinsurance, or life & annuity fields. Given the unique threats facing us as well as the changing times, I urge you to be proactive in making a difference by getting involved to the extent that you are able. Make a difference to the community as well as to our profession. Ask yourself, “What have I done for my profession lately?”

I want to thank all the council members for their hard work the past year. It really takes a lot of dedication and commitment to volunteer to help with section activities. Finally, I want to sincerely thank you all for giving me the chance to take a leadership role in a section that is really trying to make a difference. It has been a privilege to represent you.
3. **Audit committees will evolve into risk committees.**

As boards of directors recognize that they are charged with the responsibility to ensure that appropriate risk management resources are in place, they will replace or supplement their audit committees with risk committees. A number of leading institutions have already established risk committees of the board. The board’s responsibilities for risk management have been clearly established in the Sarbanes-Oxley Act, as well as corporate governance initiatives such as the Dey, Turnbull, and Treadway reports. The result of these and other similar initiatives is that board directors have begun to realize that their responsibilities go beyond traditional audit activities, and that they need to ensure resources and controls are in place for all types of risk. In terms of scope, the audit committees of the future will encompass enterprise-wide risk management.

4. **Economic capital will be in; Value at Risk (VaR) will be out.**

Managers and external stakeholders will demand a standardized unit of risk measurement, or common currency, for all types of risk. This way, they can spot trends in a company’s risk profile, as well as compare the risk/return performance of one company against others. To date, VaR has gained wide acceptance as a standardized measure for market risk. However, VaR has three major flaws. First, it does not capture “tail risks” due to highly infrequent, but potentially devastating, events. Second, its inability to capture tail risks makes VaR a poor measure for credit and operational risks (or even market risk positions with significant optionality). Third, VaR measures the risk, not the return, of any risk position. Yet financial models that have passed the test of time, such as Capital Asset Pricing Model (CAPM) or the Black-Scholes option pricing model, evaluate both risk and return. The concept of economic capital is intuitively appealing because one of the main reasons companies hold capital is to absorb potential losses from all types of risk. Risk-adjusted return on capital extends the concept and measures business profitability on a risk-adjusted basis. The Basel Committee has already adopted economic capital as the framework for international regulatory capital requirements in the banking industry. Other industries will follow and adopt it as a common currency for risk.

5. **Risk transfer will be executed at the enterprise level.**

The integration of risk transfer activities has already influenced hedging and insurance strategies. For example, companies that hedge with derivatives realize they can save on hedging costs if they execute portfolio hedges rather than transactional hedges. Companies that bundle their insurance coverage through multi-risk multi-year policies are also realizing significant savings on premiums. Alternative Risk Transfer (ART) goes one step further in combining capital markets and insurance techniques. The rise of ERM and ART products will mean that risk transfer strategies are increasingly formulated and executed at the enterprise level. In the past, companies made risk transfer decisions to control specific risks within a defined range, without being particularly thoughtful about the cost of risk transfer unless it was prohibitively high. In the future, companies will make risk transfer decisions based on an explicit comparison between the cost of risk retention versus the cost of risk transfer, and execute only those transactions that increase shareholder value.

6. **Advanced technology will have a profound impact on risk management.**

The Internet (and Intranet) will have a significant impact on risk management and how information, analytics and risk transfer products are distributed. Beyond the Internet, the increase in computing speed and decline in data storage costs will provide much...
more powerful risk management systems. Mid-sized companies will have access to sophisticated risk models that were once the privilege of large organizations. Even individual investors will be able to apply advanced risk/return measurement tools in managing their investment portfolios. Just as market risk measurement at large trading organizations is being conducted increasingly frequently, the time interval for enterprise-wide risk measurement and reporting will move from monthly to weekly to daily, and perhaps ultimately to real-time. Moreover, the development of wireless and handheld communication devices will enable the instantaneous escalation of critical risk events, and allow risk managers to respond immediately to emerging problems or new opportunities.

7. A measurement standard will emerge for operational risk.

Today, there is considerable debate not only about the quantification of operational risk, but also how to best define it. Approaches to assessing operational risk range from qualitative assessment of probability and severity based on management judgment, to quantitative estimate of potential loss based on industry and company loss histories. The lack of consistent operational loss data, partially as a function of the infrequency of major operational risk events, has led to the development of analytical models such as extreme value theory to come up with loss estimates. Other models borrow from total quality management techniques or dynamic simulations to quantify operational risk. More recently, there has been some support, and some encouraging results, from early experimentation with neural networks to recognize patterns in operational risk. As the practice of operational risk management gains acceptance, and as data resources become more available as a result of company and industry initiatives, a measurement standard will emerge for operational risk. However, the greatest challenge for operational risk will remain one of management, not measurement.

8. Mark-to-market accounting will be the basis of financial reporting.

Over time, the risk management profession has recognized the importance of mark-to-market accounting versus accrual accounting in reporting the financial condition of a company. While accrual accounting is adequate in reporting the value of physical assets, it can provide the wrong signals in reporting financial and other intangible assets. The use of mark-to-market accounting is widely accepted in the market risk field, and is gaining acceptance in credit risk management, where credit-based assets are mark-to-market given their probability of default (e.g., credit ratings or credit spreads). Given the cry for greater risk transparency from shareholders and regulators, it is likely that variability (i.e., risk sensitivity) will be much more integrated into financial reporting in the future, including the full use of mark-to-market accounting for all financial assets.

9. Risk education will be a part of corporate training and college finance programs.

As companies recognize the need to train and develop their risk management staff, corporate training programs will increasingly feature risk management. These training programs will likely be a combination of internal and external resources, and include internal workshops, external conferences and Internet-based training tools. Given the rising corporate demand for skilled risk professionals, professional organizations and colleges will continue to integrate risk management into their course offerings. Professional certification and college degree programs will gain popularity and acceptance. Similar to the development of the CFA certification in finance and investments over the past decade, a widely accepted professional certification in risk management will emerge in the next decade. Colleges will expand their course offerings beyond insurance and derivative products, and offer courses in ERM and general risk management topics.

10. The salary gap among risk professionals will continue to widen.

The trend towards ERM and the appointment of CROs has created an exciting career path and attractive compensation opportunities for risk professionals. However, this new career opportunity will only be available to risk professionals who continue to develop new skills and gain new experiences, while the others will be left behind. The salary gap that has developed over the past several years will continue to widen in the next 10 years. On the one hand, the compensation for risk professionals with cross-functional skills will increase faster than other professions due to rising demand for their services. On the other hand, risk professionals with narrow skills or who serve limited intermediary roles will not enjoy above-average raises, and may in fact see their job security decline as their jobs become less relevant in the new world of risk management.
Challenging Journey to Clear Communication: Learning to Speak the Agent’s Language

by Adrian R. Pask

Last year I was invited to explain to a room full of life insurance agents exactly how their compensation plan was going to change. The changes were substantial and had the potential to impact the way these agents ran their businesses and their lifestyles. The challenge was obvious: How would I, an analytical actuary, convey this important topic to an audience of gregarious salespeople? Would my communication to them be just “dry words” without understanding or acceptance? Looking at the bigger picture, how can we, as actuaries, go beyond our actuarial training and learn to communicate effectively with other professional groups to expand our business horizons?

At first glance, these issues may seem simplistic. There are no complex formulas for good communication. There are no regulations or standards. However, communication is more than just words. Communication is how you think about problems, how you present ideas and how you relate to your audience. After years of taking actuarial exams and training to think like an actuary, I found it difficult to relate to other groups who thought and communicated differently. The challenge for me was realizing these facts and looking for alternative ways to communicate to this group of life insurance agents.

During this journey of professional growth, I discovered a few key communication precepts: delve deeply into other people’s reality, respect others for who they are and discover who you are. These messages are simple, but turning these concepts into your own beliefs and changing your communication patterns is difficult.

This article cites specific challenges and provides techniques on how you can break the communication barrier and learn agents’ language by learning about their world. Like most difficult tasks, these challenges seem easy until you are forced to complete them.

**LEARNING THE AGENT’S REALITY**

Agents spend hours on studying, identifying and planning responses to different personality types. Agents know that sales presentations must be tailored to their audience. A presentation to a typical agent requires a fast pace and focus on results. A presentation to a typical actuary requires logical progression and a focus on numbers. What personality characteristics make an agent successful?

**Likeable, Trustworthy, Charismatic**

For an agent, the first step of the sales process is to sell himself or herself and develop a rapport with the prospect. Agents who can do this seem likeable, trustworthy and charismatic. Personal appearance is important. Smiling is important. Remembering names is important. “Important” is defined in the same way that it is “important” to an actuary to calculate reserves correctly.

I was at a dinner with a group of agents, and they spoke for 20 minutes about how a senior executive, who happened to be an actuary, did not remember their names. They were highly insulted. In the agent’s world, remembering a name can create a sale while forgetting a name can cost one. Forgetting a name has the same impact in an agent’s reality as incorrectly pricing a life insurance policy has in an actuary’s reality world.
Challenge One: Introduce yourself to 10 strangers; get their name and the names of two of their family members. Try to remember these names 15 minutes later. You will quickly see that this exercise requires a skill that most agents have taken years to develop. It is not easy to get the names in the first place, and then recall them even a short time afterwards.

Positive Outlook

A great day for an agent is closing five out of 20 sales. Agents are motivated by stretch goals that may or may not be realistic, and closing five deals—no matter what the ultimate goal—is a cause for celebration. Agents accentuate the positive and discount the negative.

On the other hand, a bad day for an actuary is accurately calculating the reserves on one out of four lines of business. It is the three lines of business incorrectly calculated that stands out to an actuary. Actuaries are motivated with achievable and realistic goals. Actuaries look at the world, identify risks and communicate those risks to their audience. For the actuary, the most challenging aspect of communicating with agents is conveying a positive outlook while maintaining a fiduciary responsibility to inform the client of potential risks.

The characteristics just discussed—being likeable, trustworthy, charismatic and positive—are part of most actuaries’ daily worlds, although probably on a lesser scale than that of a sales agent. I knew I had to be personable and positive in my presentation, but this was not my entire job. The next two characteristics of the sales personality are much harder to acquire, but they are a core part of an agent’s reality. They are skills upon which we rarely draw because actuaries live in a world more concerned with logic than emotions.

Aggressive and Always Advancing

Closing the sale is the goal of the sales process for the agent. There are many steps leading up to a close: gaining a prospect’s trust, identifying the problem, proposing a solution, overcoming objections and finally, closing the deal. At each phase of the sales process the sales professional must move the prospect to the next phase. The agent is always moving towards the next “yes.”

One important key to the sales process for agents is identifying and resolving objections. A high quality sale occurs only if all objections come to the surface and are resolved. There are two types of objections: The reason that sounds good and the real reason. The agent’s job is to uncover the real reason a sale is not occurring, often by pushing through the reason that sounds good. Agents develop a sixth sense that identifies hidden agendas. Anything less than the truth will be met with suspicion and their training will kick in to uncover the true agenda.

Hints On Dealing With The Field

So what is the value to actuaries of all this information about agents’ personalities? As we discussed previously, agents spend a considerable amount of time studying different personality types. The deeper you can experience the reality of any sales professional, the better you will be able to communicate and “sell” your ideas. Here are some of the tips I learned.

Have Fun!

The first rule when dealing with agents is to create a sense of fun by being likeable and remaining positive. This is not easy when you have a roomful of agents staring you down. The following three sales techniques help create an energized and positive environment. These comments seem simple but are sometimes difficult to fully implement.

- Smile when on a telephone call or presenting in person. The next time you are on a telephone call ask yourself, “Am I smiling?” “Does frowning change the level of enthusiasm in my voice?” “What would it take to get me to smile?”
- Remember names and use them often.
- Offer appropriate compliments. Most agents are masters in the art of the compliment. Some compliments are pleasant and topical. They make the person temporarily feel good and then are quickly forgotten. Other compliments come from a place of deep gratitude or admiration, and if they include specific examples, they remain with the recipient for a long time. Both complimenting approaches can be genuine and powerful if used skillfully. An inappropriate compliment used in the wrong context is very dangerous.

continued on page 8
Agents cultivate a positive attitude and maintain it by only associating with other positive individuals. A negative attitude grates on positive people.

**Challenge Two:** Do not criticize or complain for an entire week. Only 10 percent of what people worry about actually occurs.

**Respect the Agent’s Reality (But Live in Yours)**

When dealing with agents for the first time my reaction was, “I will just act like them—how hard can being an agent be?” This statement was rapidly tested. Being an agent is difficult. Acting like an agent is even more difficult and has the disadvantage that as an actuary, it is not your reality. A sales mentor told me, “Actuaries have great skills, skills that demand respect, but acting like a salesperson is not one of them.”

Once I relaxed and became more comfortable with both myself and my talents, I realized the truth of this statement. If you do a good job of explaining what you do, agents are in awe of an actuary’s skill with numbers and the insights they have in the life insurance business.

Authenticity is a rare commodity in life. Agents can instantly identify hidden agendas and social masks. Being an authentic person requires analysis, recognition and acceptance of your own strengths and weaknesses.

**Sell Change (Don’t Explain It)**

How you deliver the message can be more important than the message itself. Agents communicate using a sales process. Actuaries communicate using numbers in a logical sequence surrounded by theory. Agents do not have the time or patience for lengthy explanations of how something happened and the theory behind it. In their world, something works or it doesn’t, the reason why it works is not important.

Agents want to know: What is the problem that requires change? How does this change impact my world? Does this change benefit me?

The sales process is a verbal dance that dynamically communicates ideas. Agents recognize the steps and will verbally dance with you. Miss a step and you will lose them.

**Avoid Discussing Non-Negotiable Items**

A key to dealing with the field is to communicate and sell a company decision without opening a discussion that could lead to a negotiation. Do not open discussions about items that are not going to change. If a full explanation of a matter is required, do this in private or by conference call.

Warning: This is an advanced “black belt” technique that should only be attempted if you feel 110 percent comfortable with every other area outlined in this article. If you do not feel comfortable communicating a firm decision, the conversation will be anything but positive and fun. Communicating a firm decision without respect for the agent’s reality appears heavy-handed. If you do not feel comfortable selling, you will not be able to sell a firm decision.

Agents are trained to open discussions, resolve objections and negotiate relentlessly. When you open a discussion with an agent, their training moves them into an objection resolution mode which ultimately enters into a negotiation phase. Once the negotiation phase is initiated, there are two possible outcomes: The home office makes a concession or the agent loses. Neither outcome is favorable.

**HOW TO IMPROVE YOUR COMMUNICATIONS GAME**

**Spend Time with Agents**

To improve your relationship with agents is to spend time with them. This can be as simple as calling an agent asking their opinion about a product or asking about their competitors. Go to a sales conference. Buy a financial product.

**Challenge Three:** In one month, meet five agents and spend half an hour with each of them.

**Ask Agents for Advice**

Agents love to talk and express their opinions. It makes them feel good and shows that you care about what they think.

**Challenge Four:** Use the following questions as a template to ask an agent how
Learning to Speak the Agent’s Language

you can improve your communications: You excel at a challenging profession—Why are you so successful? How do you keep on top of your sales game? How can analytical actuarial personalities effectively communicate with expressive personalities?

Walk in Their Shoes

The quickest way to gain respect for another person is to walk in his or her shoes.

Challenge Five: Educate yourself about their world. Read a sales or motivational book. Take a sales class. Observe a sales call.

I participated in an eight-week sales training class. This experience forced me to interact and compete with real sales professionals week after week. I had to sell both myself and the products. I saw what motivated sales professionals and what formed the basis of their value system. I was humbled by my rough sales attempts in comparison to their smooth presentations. Agents work hard at being personable and positive. They were talented but they had to work at it. They put as much effort into being great sales professionals as actuaries put into being great financial professionals.

THE PAYOFF: PERSONAL AND PROFESSIONAL GROWTH

One of the greatest benefits to dealing with agents is the improvement in the ability to communicate. The majority of actuarial communication is formulaic, meaning that the format and content of most reports and communications are dictated by training and standards of practice. This formulaic approach is designed for actuaries to communicate with other actuaries and reduce the risk of errors and omissions malpractice.

Dealing with agents forced me to look at the process of communication. On a professional level, lacking a communication formula, I had to deeply explore my audience, my message and my fiduciary responsibility to my audience. On a personal level, the exploration of my sales audience has made me more authentic in my communications. It also forced me to break through many of my perceived limitations. Both personally and professionally, this was a worthwhile journey.

Adrian R. Pask, ASA, MAAA, is an associate actuary at Milliman USA in Windsor, CT. He can be reached at apask@hotmail.com.

Congratulations New Council Members!

The following are the newly-elected members of the Actuary of the Future Section Council. Each will serve a three-year term beginning in October, 2003.

James C. Brooks, Jr.
Bragg Associates
Marietta, GA

Paul Bruce
Capital Professional Advisors
Minneapolis, MN

Joe Paesani
Broomall, PA

Thank you to outgoing council members:

Sudha Shenoy
Anthem BC/BS of CT
North Haven, CT

Morris Fishman
Insurance Strategies Consulting LLC
Tarpon Springs, FL

Kristine M. Henderson
American Express Financial Advisors Inc.
Minneapolis, MN
Recently I surveyed professionals in the viatical and life settlement (a.k.a. secondary insurance) industry to discover how actuaries could best serve this particular business. I solicited opinions from current viatical and life settlement brokers and investment company representatives on how actuaries could add value to their industry. The survey covered areas where actuaries might be welcomed by other professionals in the industry. The full survey results and report are published on the SOA’s Web site.

As a part of my research, I attended the Viatical and Life Settlement Association of America (VLSAA) meeting in November 2002 to speak to those in the industry personally. I surveyed VLSAA industry professionals about how actuaries could best provide services. Both brokers who represent the individual client/viator and investment company professionals who represent the investors participated in the survey.

The survey included 14 areas in which personal or other actuaries could serve the viatical brokerage and investor companies. The survey was intended to be general; therefore the exact nature of the actuarial work needed was not probed. Many in the industry are not aware of specific capabilities of actuaries, but they are familiar with the broad general areas in which actuaries are typically associated. Out of approximately 28 people who attended the meeting, 22 completed surveys. In every applicable question, respondents indicated a need for actuarial help.

Issues in the Viatical Industry

The three primary issues facing the viatical industry currently are fraud, state regulations and mortality assumptions.

In November 2002, a popular consumer advocate based in Atlanta, Clark Howard, did a segment on the local news concerning “viaticals.” Howard interviewed a duped investor from Jasper, Georgia who had hoped for up to a 40 percent return on his investment in “viaticals.” The company he invested with was a Florida firm that was no longer in business. Howard stated that half of “viaticals” were fraudulent, with no reference as to where such statistics were derived. Investors have filed a class action lawsuit against the investment firm, First Financial.

The book *Blue Latitudes*, by Tony Horowitz, describes an island named Tonga that invested funds in the “viatical industry.” On page 268, it explains that the throne of Tonga “issued a royal decree naming as ‘court jester’ an American Buddhist who was also entrusted with managing the country’s trust fund. The jester gambled most of the fund on America’s unregulated ‘viatical industry’—buying the insurance policies of elderly or terminally ill patients, in hopes they’d die while the policy was still worth more than its cost—and promptly lost $20 million U.S., or more that half the annual budget of Tonga’s government.”

Concerns about fraud have caused regulators to become more active in this industry.

State regulations were a big item of discussion at the meeting. Some states do not regulate the industry at all. The National Association of Insurance Commissioners (NAIC) is drafting a model regulation for states to adopt. At their March 8, 2003 meeting in Atlanta, the NAIC Viatical Settlements
Working Group of the Life Insurance and Annuities (A) Committee addressed some of the industry concerns regarding the proposed Viatical Settlements Model Regulation. The committee is currently soliciting comments regarding the draft regulation.

The states are beginning to take note of the viatical and life settlement industry with new regulations and licensing requirements. For example, Iowa regulations establish required fiduciary duties of the brokers to the viator. The Iowa regulation specifically exempts attorneys, CPA’s, accountants and nationally accredited financial planners from fiduciary requirements without mentioning actuaries. The exemptions assume certain professionals already have their own standards of practice. The omission of actuaries indicates a lack of awareness of actuarial involvement in the industry. At the other extreme, New Jersey requires that an actuary review every viatical or life settlement transaction.

Thomas Moran, who works for The Heritage Group, stated at the NAIC Viatical Settlement Working Group meeting on March 8: “The biggest problem the viatical provider companies are having is incorrect life expectancies...People are living too long...As a result the problem manifests itself in the premium reserve diminishing too fast and the money is not there to pay premiums.”

Investors in the secondary insurance marketplace are relying on life expectancy calculations and assumptions about mortality that are often not reliable. The reasons include the calculation itself, the underlying standard mortality assumptions and the substandard adjustments. Current financial problems for life settlement investors could be alleviated by access to better life expectancy evaluations. Accurate life expectancy estimates are critical to the long-term success of all secondary insurance transactions.

Members of the VLSAA need more data, including updated senior mortality rates. They need mortality studies performed on their clients. Many viatical companies are willing to share their data for this purpose.

Investors in viatical and senior settlement policies need accurate mortality assumptions to make a sound investment. Mortality assumptions at older ages are often set too high, to make the policies look more attractive to the buyer. Even with factors added to a standard mortality table, such as the 75-80 Basic mortality table (which is often used) the underlying senior age mortality assumptions may still be unreasonable.

According to Bragg Associates, an actuarial firm specializing in mortality tables, relatively younger ages out of the senior age group are experiencing lower mortality than many annuity tables would indicate. Jack Bragg, FSA, of Bragg Associates, asserts that the mortality slope of the 2000 Valuation Basic table (the basis of the 2000 CSO table) is too steep at senior ages, except at the very end of the table, as compared to his recent experience studies. In other words, Bragg suggests that senior mortality rates in such published tables are generally too high except at the very oldest ages at the end of the mortality table. Some table rates may be purposely set high to promote conservatism in reserve calculations for death benefits. The published table rates are not reliable for life settlement purposes.

**Opportunities and Concerns for Actuaries**

Overall, actuaries are welcome in many areas. The most cited areas included working with the NAIC, life expectancies and associated risk factors, financial projections, understanding life insurance policies and reinsurance, and evaluating settlement offers arising from lawsuits. Another potential role for actuaries is working with physicians in assessing mortality implications of medical impairments.

One respondent indicated that an actuary was on retainer with the firm he/she represented, but did not elaborate as to what capacity. Actuaries have been retained by viatical investor companies to evaluate life expectancies. Actuaries could help determine a fair price in any case, where all parties could be more satisfied in the long run. To find an actuary, most would call either the Society of Actuaries or search on the Internet.

One of the concerns of those in the viatical industry regarding actuaries is that their consulting fees may be too high. New Jersey’s requirements raise concerns by viatical brokers and investors that the requirement will effectively make the secondary insurance transaction too expensive.

Regardless of what opinions are about the viatical and life settlement business, it exists. Actuaries could contribute to rationalizing the determination of risk in the market, offering a more fair and equitable value for the public.

continued on page 12
This study illustrates that a lot more work could be done, such as researching the viatical and life settlement industry further, educating actuaries to serve this and other areas, and educating the market and the public. Studies could delve further into specific issues in areas where actuaries should play a role. From the survey results we know that actuaries can become involved in many ways, but the issues related to the general areas need to be defined. For example, are there certain life insurance provisions that cause difficulty?

Actuaries could enter the reinsurance area by helping with mortality projections or providing a stop-loss type of reinsurance product that would protect the investor against a loss caused by the insured living beyond a certain number of years. Actuaries can provide such probability estimates as well as an analysis of deviations of actual mortality from expected. A short overview of the reinsurance needs in this marketplace and a description of the actuarial role related to reinsurance could be produced by future studies.

Actuaries can advise individuals either through brokers directly. In addition, actuaries can provide advice on tax implications, especially for very wealthy clients. An actuary could help individuals examine all of their options to make an informed decision. Research work could be undertaken to help actuaries best calculate an actuarially fair settlement and to provide ethical and professional advice to consumers as well as investors.

Involvement by actuaries could enhance the life settlement process in many ways, including: determining prices of life settlement contracts, helping individuals understand the fair value of the contract, helping brokers in assessing values of contracts, providing life expectancy education to those in the industry and the public, and working with investor companies on purchase prices and reinsurance costs. Actuaries could help analyze and correct improper life expectancy calculations being generated for the industry.

Actuarial professional associations should consider partnering efforts with viatical and life settlement industry associations. There is clearly a need for more communication between our professional associations. The American Academy of Actuaries has helped publicize the profession through its Contingencies magazine and other efforts. The SOA External Relations Committee is seeking to connect with other professional organizations, recognizing that the task of educating actuaries cannot be done in a vacuum. Much is being done to expand the reach of actuaries. Much more can be done to open doors in emerging markets and we need continued dedication of the actuaries that are involved in these organizations.

For more basic information on the viatical and life settlement industry, refer to the full paper online.

References


Blue Latitudes, by Tony Horowitz, page 268.
Don’t Miss The Actuary of the Future Sessions at the Annual Meeting in Orlando!

Monday, October 27
2 p.m.–3:30 p.m.
SESSION 25 PD

CAREER PIONEER PROGRAM

Moderator: Marc N. Altschull
Panel: Michael M. Braunstein, Sean Patrick Casey, H. Dietrich Moor, Joseph Paesani

The Actuary of the Future Section created the Career Pioneer Program in 2002. The panel explains the program and shows how it facilitates actuarial employment in new businesses and fields nontraditionally employing actuaries.

Tuesday, October 28
10:30 a.m.–12:00 noon
SESSION 75 OF

THE ACTUARY AT RISK

Moderator: Stuart F. Wason
Panel: W. Grant Hardy, Ramy Tadros

Panelists lead a discussion and update members on recent events in the rapidly evolving area of risk management. Actuarial roles and opportunities in enterprise risk management and as chief risk officers are specifically addressed.

Attendees have ample opportunity to ask questions of the panel. At the conclusion of this session, attendees understand actuarial prospects in the risk area and the need for action to establish an actuarial presence.

Wednesday, October 29
2 p.m.–3:30 p.m.
SESSION 132 OF

Specialty Track: Actuary of the Future/
Financial Reporting

REPUTATION RISK MANAGEMENT

Moderator: Lynn Brewer

Having spent time with Enron’s water company, trading division, power trading desk and their broadband unit, Brewer knows all too well what happens when ethical behavior is given no incentive. Corporations need to develop a culture and a strategy of reputation risk management. This session discusses specific reputation risk management metrics that companies can implement, such as how to determine what kinds of sensitive deals should be brought to the Board of Directors, or how to reward individuals who provide accountability, certainty or transparency to the company.
Author’s Note: Session speakers were Abe Gootzeit, Cindy Miller Susan Hedrick, Sudha Shenoy moderated.

Abe Gootzeit—
Managing Careers From A Consultant’s Perspective.

Abe Gootzeit talked about David H. Maister’s advice to take “The courage to care about your people, your clients and your career.” Important contributors to success include such as listening, quality service, assets, marketing, intolerance and collaboration. Listening actively to the client’s needs and delivering what the client wants are key attributes that consultants need to possess.

This is Maister’s First Law of Service: Satisfaction equals Perception minus Expectation. Look at your assets—improve the balance sheet and not the income statement. Professionals should be assessed less on the sheer volume of work and more on the type of work they do. Market to new clients and always help them win. Do not tolerate low performance and remember that collaboration is critical to your success. Remember the keys to success: develop a personal strategy, manage your time, develop relationships relax and have fun.

Cindy Miller—
What It Takes To Have A Successful Actuarial Career Within An Insurance Organization?

“Success” is defined as achieving an officer level position within an insurance organization. Key attributes were compiled based an on informal survey of 25 actuaries (15 of 25 responded). They include: strong communication skills, strategic thinking, broad business experience and knowledge, management and interpersonal skills and work ethic and credibility. Strong written and oral communication skills are also very important.

Remember to tailor your communication style to your audience—be able to communicate technical issues to a non-technical audience. Develop good listening skills and the ability to connect the pieces of the puzzle. Strategic thinking skills include seeing the big picture, being innovative, embracing change, being flexible, and presenting solutions, not problems.

Be willing to make decisions on less than perfect data. Be a business person first and an actuary second. Focus on the critical (80/20 rule); be a lifelong learner. Find a mentor (actuary versus non-actuary) and understand the responsibilities of your peers and management. Be willing to take risks and volunteer to lead projects, both actuarial and non actuarial. Be a strong team player, a strong manager and a leader.

Do not micro manage. Provide a vision for your team and allow your team to participate in projects.
from start to finish. Be personable and remember: first interactions are critical. Work hard and learn to accept responsibility for your actions. Do not be afraid to say, “I don’t know, but I’ll find out.” Actuaries are acknowledged as being intelligent and technically proficient, and we need to show that we are good business people as well, by focusing on these skills.

Susan Hedrick—
The Power Of Learning and Development

Susan focused on the importance of learning and development, mentoring, exam strategy, time management, project management, presentation skills, managing others and business etiquette. So goes the Chinese proverb: “If you want one year of prosperity, grow grain. If you want ten years of prosperity, grow trees. In order to achieve a hundred years of prosperity, grow people.” Find a mentor who will give you positive and negative feedback and has time to spend with you. Define the mentoring period. Consider being a mentor. The mentee will benefit from the mentor’s experience, accelerated learning and broadening network. The mentor will have the satisfaction of training tomorrow’s leaders and will learn to enhance listening skills.

Find a buddy and finish exams as quickly as you can while still investing in your career. Find time management and project management tools that work for you. Plan three minutes for each minute of meeting time and always have an agenda. Practice presentation skills and identify the “top three” list. Remember, the manager is the main reason people leave a job—not money.

The session included good participation and questions from the audience. We had a great panel of speakers with varied backgrounds and experience, and the session helped us gain new insights into managing careers within a traditional setting.