The Personal Actuary
A New Star in the Universe of Financial Advisors

By Paul Richmond

The American public is beginning to discover that it has a need for practical financial advice. Until recently, the average Joe thought financial planners were for millionaires, sports stars, and Hollywood types. However, as members of the baby-boom generation approach retirement, they are discovering that they may not have planned as carefully as perhaps they should have, or their parents didn't plan sufficiently and now need assistance with day-to-day affairs. A Personal Actuary, an all-encompassing provider of comprehensive financial advice to individuals, and an emerging discipline within the actuarial profession, may be just the answer needed to address the multitude of challenges looming ahead.

The graying of America along with the continuous pruning of older workers by the corporate world, has resulted in many 50-somethings being forced into phased retirement. The high paying jobs they worked while in their 30s and 40s are no longer available to them. They have the skills, the ability, and even have the stamina, but they no longer have the youth that is perceived by big business to be so vital to its success. Consequently, the middle generation is becoming employed in jobs that require less skill and, as a result, provide less pay. For the first time, members of this generation are under-employed and must confront a future that isn't as rosy as they had anticipated. Additionally, they are beginning to seek professional help to identify their individual financial resources and needs and to create a realistic vision of what their lifestyles may be over their remaining years.

Unfortunately, no clear pathway exists for the general public to find the right advice, or advice that is appropriate to the need. The public at large erroneously believes that insurance salespersons, sellers of mutual funds, financial advisors, financial planners, stock brokers, and investment advisors are all capable of giving financial advice. The public is generally unaware that financial occupations fall into two broad categories – those who can sell financial products (mutual funds, stocks, bonds and other securities, insurance and annuity products) and those who are permitted to give financial advice for a fee.

The general public and sometimes even financial professionals themselves have difficulty distinguishing between those who may sell product and those who may give advice. Complicating the issue further is the fact that many who are properly credentialed to give advice also sell product. And many who sell product give advice without being properly credentialed. About the only ones who really understand who is allowed to sell product and who is truly permitted to give financial advice are the regulators, the NASD, and perhaps, and/or hopefully, those who market themselves using these terms.

The crux of the matter is the definition of "financial advice." Does a person who sells product for a commission give financial advice? How can he or she not give advice? How is such a salesperson distinguished from a person who sells advice for a fee? Well, the SEC, the NASD, and the state and federal regulators provide guidance and an examination/credentialing process, so hopefully, the financial professional knows what he or she can and cannot do. Unfortunately, the public is not as well informed.

Let me cite a personal example. I have worked in the financial arena as a pension actuary for many years and now am in the midst of redirecting my career toward assisting clients with financial and investment planning. I have passed exams that permit me to sell mutual funds, life insurance, and annuity products. I can give information about the products and receive a commission upon completing a sale. But I cannot give any financial advice. I am required to inquire somewhat about my client's financial health and stability, but not too much. I can sell mutual funds with a limited knowledge about their needs, but am precluded from doing an in-depth analysis unless I am willing to do the work and not charge for it. My clients perceive me as a "financial advisor," but I really am not. The questions I must ask lead my customer to believe I am seeking the information so that I can advise them. As a result, I am perceived to have much more knowledge than what I actually have been tested for, and I am perceived as being qualified to give advice.

Seeking appropriate and competent financial advice is a challenge. In spite of the advertisements on TV and other media for the large mutual funds, insurers, and other financial institutions, there are no branded advisors.

Branding associated with the fast-food industry is very clear. When I want a hamburger, I can go to McDonald's, Wendy's, Fudrucker's, or Dave's Lunch down the street. At McDonald's, I know that the hamburger served to me will be mass produced and slapped together with ketchup, pickle, onion, and mustard. I don't even have to ask. At Wendy's, I get a better quality burger and more condiment choice. At Fudrucker's, I will get an even big burger and an even higher quality and quantity of toppings. What do these hamburger joints have in common? A recognized national reputation that provides continuity of product no matter where you are. However, Dave's Lunch does not have a national brand. I just know that I will get the best burger ever – big, greasy, tasty, and prepared just the way I want it. I know this because I have eaten there many times before, and it was good. Any maybe even better yet, the only ones that know about Dave's burgers are us locals.

Branding associated with financial services is not nearly as simple. The public in general doesn't know the basics. Individuala may know they have a need, but they don't know how to define the need, or to discover who can help them with the need without assistance. The major national names – The Principal Group, Nationwide, Ameriprise, Fidelity, Putnam, etc. – have a sophisticated menu of products and have posted their menus on their websites, but the general public doesn't have a clue about how to apply these products toward solving their problem(s). They don't know whether to buy a mutual fund, an annuity contract, or a CD. They don't understand the mechanics of the financial instruments. They do not understand how these products are used as building blocks to achieve financial security. Nor do they know where to go to obtain answers to these questions.

The following example is a simple illustration of the challenges a person can face. Florence is 55 years old and has just received an inheritance of $200,000 from her mother who recently passed away. She goes to a bank for financial advice. She first speaks to a teller who directs her to the branch manager. The manager listens as Florence describes in basic terms that she wants to use the money for retirement, but the bank officer is busy and doesn't really have time to really ask the questions that she needs to ask in order to fully understand Florence's situation. And to be fair, she may not even have the training to ask the appropriate questions. However, the manager does have an incentive to steer customers to high-margin products, so she recommends that Florence purchase CDs. The manager is happy because she has made a sale.

The tragedy of this story is that Florence went to the bank because she wanted financial advice on how to best deploy her inheritance to facilitate her retirement. She expected the branch manager would help her identify life goals and objectives and then direct her to investments that would help her achieve those goals. What she received was a salesperson who sold her CDs because it was an easy sale and because the manager had a monthly quota of CDs to sell. In a few minutes, Florence was back on the street wondering, at best, "What just happened?" or at worse, thinking, "I have just secured my future."

Over the next ten to twenty years, the need for qualified financial counselors and investment planners will expand rapidly. This trend creates significant opportunities for those inclined toward financial professions, but also significant risk for the general consumer of financial services. Considerable opportunities exist for ethical people, with a high degree of analytic ability, to perform these services, proving a valuable public service, while at the same time being rewarded handsomely. Unfortunately, the growth of this industry will attract even more charlatans and will require an even greater level of policing than currently exists.

In light of this, financial services industry needs to embrace the actuarial profession. And it is time for the actuarial profession to raise its hand and demonstrate how it can help.

Opportunities for actuaries have been diminishing over the past several years. The need for pension actuaries has diminished substantially over the past decade as corporate retirement plans have been converted from defined benefit to defined contribution. The average pension actuary is well over age 50. The number of pension actuaries under age 50 at the last Enrolled Actuaries meeting could have been counted without having to take off your shoes and socks. Similarly, the need for life actuaries has also declined. Insurance company mergers have made many actuarial positions redundant.

On the other hand, the financial services industry is experiencing substantial growth and will continue to do so in the foreseeable future. Because of the aging of America, we will see growth in the financial sector that will outpace the number of qualified financial professionals willing to serve with integrity. Who can fill the void? Personal actuaries, derived from the ranks of pension and life actuaries, who have already been substantially trained to address the emerging needs. All they need is a clearly defined pathway that will promote an effective transition from their former disciplines into the financial services arena. Support from the governing actuarial bodies, such as the Society of Actuaries, is also needed to help create the appropriate channels and remove barriers.

Actuaries should not expect the financial industry to welcome them onto their turf. Nevertheless, given the compelling need for advice, and the skills and integrity that actuaries offer and can provide, the time for change is now; the opportunity to transition into the financial service sector has never been better and perhaps never will be.

To illustrate how an actuary can be an effective financial analyst, consider Marjorie's case. Marjorie entered the workforce during World War II as a secretary and clerk. Near the end of the war, she joined the Army and served stateside for about two years. Upon her discharge, she obtained employment at a local state university where she worked continuously as a secretary/clerk until she retired in 1984. She also enlisted in the Army reserves during the Vietnam War period and served an additional three years as a "weekend warrior."

Marjorie never married. She lived with Mom and Dad until they passed away in the 1970s. Her life was stable and routine. Her work responsibilities and hours were well defined. She used public transportation to get back and forth from work each day.

Marjorie never made much money. Her needs and desires were small. Mom and Dad cooked for her each night. After her parents died, Marjorie began to eat out more frequently because she never learned to cook. She enjoyed hobbies, attended church, and participated in church activities. She acquired a few intimate friends over the years and became very comfortable with her small circle of family and acquaintances. She lived comfortably, but modestly. She didn't travel. She spent within her means.

Marjorie retired in 1984. She received a very modest pension, about $300 a month. Social Security provided another $600 a month. Her living expenses were modest because she had inherited her parents' duplex. Rent from the apartment provided another $400 a month.

One of her close friends became a millionaire, even though she lived as modestly as Marjorie. Her friend died about four years ago and left Marjorie about $100,000. Marjorie used these funds to supplement her retirement income and provide for her retirement needs.

Marjorie is now 85 years old. She is in excellent health physically. She takes no medications. However, she is beginning to show signs of Alzheimer's, and it is obvious that she cannot safely live alone much longer. She has almost entirely consumed the $100,000 inheritance, donating most of it to every charity that happened to send mail to her. Her current assets include the duplex worth about $175,000 and about $10,000 of stock. She has supplemental health insurance, but no life insurance. She has two relatives, a brother who is 88 years old and although in good health is only marginally able to manage his own affairs, and a 55-year-old niece who is married and has many family issues of her own to contend with.

Needless to say, Marjorie has some major problems and no one really able to help her with them. Readily identifiable issues are summarized below:

1. Who does Marjorie turn to for help? Her brother is not able, and her niece is too busy.

2. Who will decide when she should enter an assisted-living facility? Her decision-making ability has already been compromised and will continue to deteriorate. How does she find an appropriate facility, and how will she pay for her residency?

3. What Social Services – Medicare, Medicaid, Veteran's benefits, etc. – are available to her?

4. Should she sell the duplex and use the proceeds to pay for the assisted-living facility? How long will her money last?

5. Should she continue to own the duplex and rent out both apartments? Will this provide enough income to support the monthly cost of assisted living? Who will manage the duplex for her?

6. Is she eligible for Veterans benefits, and if so, how much will she be entitled to on a monthly basis? Will this benefit change if she should sell the duplex and have cash assets?

7. Who will manage her day-to-day affairs – pay her bills, complete and file her tax returns, assist her with required interactions with Veterans Affairs, Medicare, Medicaid, the IRS, her health insurance provider?

8. How should she invest the proceeds from the sale of the duplex? CDs? Mutual funds? Annuities? Other? As a practical matter, she will be consuming about

$30,000 of these funds a year. How does this limit her investment options? Would stochastic asset/liability modeling provide useful information about the effectiveness of alternative investment strategies?

9. When will Marjorie run out of money? And what will happen to her at that time? Ideally, she would spend her last dollar on the day she dies. But what is the likelihood of that occurring? What is the likelihood of her running out of money? When may that event occur? What will happen to her then? What is the tradeoff between the consumption of resources and quality of life? Should she diminish her current quality of life to make sure she doesn't outlive her resources? Will her quality of life in five years be so diminished that resources will have little effect on her quality of life?

10. How much are her two relatives willing and capable of doing for Marjorie? Can they be relied on? Will they be willing to use Marjorie's resources to pay for advice and assistance?

Marjorie is unique, and yet she is not. Her particular set of circumstance are obviously one of a kind. It is unlikely that you will find another person with the same fact pattern. However, the underlying issues are not unique. They occur and reoccur in various permutations and combinations throughout your own community, state, and country. The facts are:

1. Senior citizens are living longer and many are now approaching a time when they must make a major transition from independent living to assisted living of some type.

2. Baby boomers not only have to manage their own financial future, but the financial future of their parents as well.

3. Senior citizens need considerable assistance addressing financial and housing decisions associated with aging and yet do not have the knowledge to do so.

4. Numerous senior citizens do not have close family members nearby to assist them with their financial needs and other concerns.

5. Baby boomers with parents are frequently too busy with their own lives to spend meaningful time helping their parents with these financial matters. They are not equipped to address these issues themselves and do not know where to turn for answers. They are willing to pay for assistance as long as they retain the decision-making authority.

6. The financial community has been constructed to sell product, not to resolve problems. The primary objective of financial organizations is to accumulate assets, not to provide advice.

7. Many "financial advisors" are willing to sell product to senior citizens without making any attempt at understanding the need. The important thing is the sale. "Setting the hook" is the focus of much of the corporate training given to the sellers of financial products.

8. Our senior citizens and the baby-boom generation are very vulnerable to unscrupulous "financial advisors."

A tremendous opportunity exists for actuaries to assist senior citizens and baby boomers with these issues. Actuaries, who have been schooled in financial modeling, probability analysis, risk management, financial analysis, financial products, demographics, actuarial mathematics, and the American social safety net, have a skill set that is not generally available with any other profession. The ability of actuaries to provide this assistance is only further enhanced when combined with the reputation for integrity that actuaries have earned throughout the years.

In light of this:

- Are you ready to become a Personal Actuary?

- Is the Society of Actuaries ready to help actuaries make the transition?

- Will the financial community accept actuaries as "partner" advisors or will actuaries be viewed as competitors?

The time is right for the emergence of the Personal Actuary. The Society of Actuaries has already begun to investigate the role of the personal actuary and how to provide meaningful support. The financial community may very well provide resistance, but the opportunity is so great that the entry of the actuarial profession into this arena will have a negligible effect on opportunities available to other non-actuarial financial professionals.

Paul Richmond is the president of Richmond Retirement Services, a boutique consulting firm specializing in risk management for individuals. Mr. Richmond started his Pittsburgh based firm in 2001 after an 18 year career as a principal with William M. Mercer. For further information about Personal Actuaries, please contact Paul at paul.richmond@verizon.net or 412-833-4170, or Jim Brooks, chairman of the Personal Actuary Task Force, at jimbrooks@bellsouth.net or 770-579-1454.