

The Actuarial Update

VOLUME 20 NUMBER 11

AMERICAN ACADEMY OF ACTUARIES

NOVEMBER 1991

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- Actuarial Standard of Practice No. 18
- Special Subject Supplement
- Introduction and Table of Contents to Standards Handbook

Politics of National Health Care Reform



Representatives Pete Stark (left) and Bill Gradison (far right) debated national health care reform at the Academy's Annual Meeting, September 26.

by Alan Kennedy

One year after the Pepper Commission challenged the nation to health care reform, congressional leaders on that commission say that nothing is likely to happen soon.

Addressing the Academy's Annual Meeting, House Ways and Means Health Subcommittee Chairperson Pete Stark (D-CA) and ranking minority member Willis D. Gradison, Jr. (R-OH) said competing interests in the marketplace and lack of leadership from the White House combine to make reform of the health care delivery system unlikely at the federal level this year or next.

"I had thought that 1990 would be the year of the studies, and 1991 the year of synthesis and analysis, and that we would move toward some action in '92," said Gradison. "I was wrong." For one thing, he explained, some important studies haven't been completed, such as the American Hospital Association's.

As for the Bush administration, Gradison added, "I don't know when or whether the administration will come forward with a health plan."

Stark, who with Gradison was a vice chairperson of the U.S. Bipartisan

Commission on Comprehensive Health Care (the Pepper Commission), said issues that divided the commission continue to get in the way of consensus.

"The kind of plan which I would prefer philosophically, but I'm having some trouble figuring out how to pay for . . . would be [a] refundable tax credit for people of modest income to let them buy their own health insurance," stated Gradison.

Stark said his own philosophy is that (1) access to health care should be a universal right, (2) providers of care should be paid "in a reasonable manner," (3) "we all ought to pay for care according to our ability to pay."

But having said that, "everything falls apart," he said, over issues such as how to contain costs, how to provide access for the uninsured, whether most health insurance should continue to be based on employment, and whether coverage ought to be mandated; if it is, said Stark, there will be another battle over allocating costs.

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From the ASB



by Walter N. Miller

Halcyon Days

As I complete my second term as chairperson of the Actuarial Standards Board (ASB), it's good to see the increasing recognition of the ASB by regulatory bodies. For example, the instructions to the National Association of Insurance Commissioners (NAIC) Life and Accident and Health Blank now require that the actuary signing the statement specifically state that his or her methods conform to the standards of practice of the ASB. In addition, the NAIC's model Standard Valuation Law incorporating the concept of the valuation actuary requires that a qualified actuary's opinion be based on ASB standards. Various state agencies have also turned to the actuarial standards of practice when drafting regulations. For example, Actuarial Standard of Practice No. 3, *Relating to Continuing Care Retirement Communities*, has served as the guide for regulation in several states.

This growing, real-world acceptance of the actuarial standards of practice promulgated by the ASB has reflected the board's determination to address new areas of actuarial practice and to tackle tough problems. Two current projects illustrate the attempt to provide guidance to actuaries working in emerging areas of practice. These are the recently adopted standards on long-term care insurance and on actuarial appraisals. Providing guidance in new areas of practice will help to ensure that actuaries continue to play a leading role in the analysis of financial systems and the evaluation of future risks.

The ASB has demonstrated its willingness to take on difficult issues. For example, the board acted to clarify the responsibilities of actuaries in estimating and providing for HIV-related claims. In dealing with this issue, it also demonstrated flexibility and responsiveness to members' concerns. After exposure of a proposed standard on recognizing the financial implications of HIV-related claims, the ASB responded positively to the majority of comments that a specific standard was unnecessary because

the ground could be adequately covered by existing standards with the addition of a current interpretation.

In deciding when to take a proactive stance and how to respond to public and professional concerns, the ASB must walk a fine line. While the ASB should not follow the dictates of outside bodies, be they public or private, it has a duty to anticipate and respond vigorously to emerging actuarial issues and to take reasonable steps to help enhance the role and scope of our profession.

I have been involved in the standards movement since 1987 and believe that the ASB has accomplished much in its short life. Looking ahead, I think the ASB will continue to build on the excellent work that has been done to date. Some of the issues that I think the ASB will focus on in the future include developing broader, more general standards and working to ensure consistency of parallel standards in different practice areas.

I'm retiring as ASB chairperson and will no longer be directly involved in the development of standards. However, I plan to continue to participate in standards development in a way in which I would urge actuaries to participate: by reviewing the exposure drafts and letting the board know what you think. Every comment is given serious consideration, and the standards that are finally promulgated are improved and strengthened by your involvement.

Working with the members of ASB and its operating committees has been a high point of my professional career. Again and again, I have been impressed by the work of the army of volunteers who support the ASB. The work products of the ASB represent many, many volunteer hours.

Let me close by offering my sincere thanks to my colleagues who give so freely of their time, energy, knowledge, and expertise, as well as to Christine Nickerson and Alan Kennedy, our very able staff people.

Jack M. Turnquist will succeed Walter Miller as ASB chairperson in January 1992.

The Update welcomes letters from readers. Letters for publication must include the writer's name, address and telephone number, and should be clearly marked as "Letters to the Editor" submissions. Letters may be edited for style and space requirements.

Letters to the Editor

All Invective Aside

In the September *Update*, Gregory Savord criticizes the two public members of the Social Security and Medicare boards of trustees for "an attack on the professionalism of the chief actuary of the Health Care Financing Administration (HCFA)." He went on to say, "Even though the public trustees have no actuarial credentials, their statement appears to be calculated to pass judgment on the professional judgment of the chief actuary and the actuarial profession."

Obviously, the profession should be concerned about any such attack. What did the public trustees do? They dared to suggest that the chief actuary's qualification of the actuarial certification for the Hospital Insurance (HI) program was unjustified and went beyond his statutory responsibility. Mr. Savord continued, "It takes great courage for the chief actuary to qualify his certification with regard to the methodology and assumptions in the face of this sort of pressure from 'big shot' political appointees."

Mr. Savord's praise of his boss notwithstanding, readers of *The Update* might be interested in the views of a more disinterested observer. First, they should know that the public trustees are not political hacks. The law requires that one be a Democrat and the other a Republican. They are appointed by the President to four-year terms, subject to Senate confirmation. The current trustees are a former Commissioner of Social Security and a former head of the Labor Department's Pension and Welfare Benefits Administration. They may not have actuarial credentials per se, but they are not completely ignorant of such matters, either.

HCFA's chief actuary made two complaints in his actuarial certification:

1. The long-range actuarial balance should be calculated using a modified average-cost method, rather than the current present-value approach.
2. The assumed 1.1% annual real-earnings growth is inappropriate, considering historical experience.

Regarding the first point, the chief actuary has tried and failed to persuade various groups of actuaries, including

committees of the Academy and the Society of Actuaries, that the present-value approach is flawed because it "imputes" inappropriate interest earnings. This is clearly a minority view that was most recently rejected by the Social Security Technical Panel to the Advisory Council on Social Security. The technical panel included four actuaries, one of whom served as chairman. The Social Security Act requires the chief actuary to certify "that the techniques and methodologies used are generally accepted within the actuarial profession." Can anyone say that this is not true with respect to present-value techniques and methodologies?

Regarding the second point, the technical panel recommended an assumption of 1.0% annual real-earnings growth. The trustees considered this recommendation and lowered the assumption of 1.3% growth, used in the 1990 report, to 1.1% for 1991. The law requires the chief actuary

to certify "that the assumptions and cost estimates used are reasonable." The chief actuary of the Social Security Administration found the assumptions to be reasonable and said so in his actuarial certification for the Old Age, Survivors and Disability Insurance program. Is he unprofessional or a captive of the politicians? I think not.

As a final point, Mr. Savord notes that "the majority of the trustees declined to join the two public trustees in their statement." The other three trustees are Cabinet secretaries (of Treasury, Labor, and Health and Human Services) who may have believed that commenting would be inappropriate. On the other hand, how do we know that they were even asked to join in the statement? In any case, they certainly did approve the methodology and assumptions used in the reports.

Like all professionals, actuaries have to be careful not to suggest that our

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"So, do you think I should increase my coverage?"

Illustration by Andrew Toos

1991 Annual Meeting Report

Metzenbaum Issues a Legislative Wake-Up Call

by Anna Fierst

In a morning speech on September 26 to Annual Meeting attendees, Senator Howard Metzenbaum (D-OH) trumpeted many of the insurance industry's regulatory flaws and the need for S. 1644, the Insurance Protection Act of 1991. Metzenbaum looked back at the legislative history of the mid-1940s by recalling his reaction to the McCarran-Ferguson bill. At the time, Metzenbaum was serving in the House, and it was

commissioner." As a consequence, "they don't intervene quickly enough." He also touched on the lack of regulation of the reinsurance business and the fact that more than 50% of reinsurance companies are offshore and are therefore unregulated by the states.

Metzenbaum cited another example of a weakness in state regulation. Venturing that the National Association of Insurance Commissioners (NAIC)

may lack the will "to act forcefully enough," he stressed the long delays in the adoption of model acts. As one example, the 1985 "Model Regulation to Define Standards and Commissioners' Authority for Companies Deemed To Be in Hazardous Financial Condition" has not (in large part) been acted upon. In this instance, "no state has adopted this model, and only nine have passed what the NAIC defines as legislation related to the model law." On another issue, it took

twenty years for all fifty states to adopt some version of the Life and Health Insurance Guaranty Association model act.

These issues and others are behind Metzenbaum's recent introduction of S. 1644. This legislation would establish the Independent Insurance Regulatory Commission (IRC), headed by five presidential appointees to be approved by the Senate. The IRC would accredit states based on the states' adoption and implementation of minimum solvency standards. State accreditations would be periodically reviewed and selected companies examined in order to track the regulatory efficiency of a particular state. Metzenbaum noted

that the IRC would not have regulatory authority over companies operating within the confines of only one state, however, because federal authority extends only to interstate commerce.

Under the bill, the IRC would set federal standards in twenty-three areas, e.g., regulations for capital, surplus and limitations on involuntary transfers of policies by insurers, consumer disclosures, policy simplification requirements, mandates for annual CPA audits, and standards for evaluation of real estate. Another major change would be uniform federal regulation of reinsurers in a way that would apply equally to foreign reinsurers.

Just as banks rely on a federal reserve fund, under Metzenbaum's bill, insurers would rely on a National Insurance Guaranty Corporation, presided over by five presidential appointees, plus the Secretary of Treasury and the Comptroller of the Currency. Funds would be supplied by upfront assessments against all interstate insurance companies. Metzenbaum suggested that the current bill could be modified to authorize the fund to be drawn upon if an apparently healthy company experiences a panic run by its policyholders. The other aim of this national guaranty corporation is to become the official liquidator for interstate insurers. Metzenbaum pointed out the lengthy delays imposed by lawyers and accountants during liquidations, and noted that streamlining the process "would probably lower the cost."

Hearings are expected to occur this fall on S. 1644; the bill has been referred to the Commerce Committee and is being studied by the Consumer Subcommittee under the guidance of Senator Richard Bryan (D-NV). On the House side, Representative John Dingell (D-MI) is expected to introduce legislation on federal solvency standards. In summation, Metzenbaum acknowledged S. 1644's imperfections and stressed his willingness to negotiate with groups such as the American Council of Life Insurance, associated for the property/casualty industry, and the actuarial profession.

Fierst is editorial assistant for Contingencies magazine.



Senator Howard Metzenbaum

apparent to him that while there was the appearance of lending adequate state regulation, it "was really a mirage. . . . Once you looked through the veil, you could see it was not adequate."

The 1980s, he noted, brought radical changes in the industry, but the regulators didn't keep up. Citing the example of Executive Life's 1985 clean bill of health, Metzenbaum criticized state commissioners for allowing "gimmicks that mask financial problems." The state regulation system lacks muscle because "many of the regulators come from the insurance industry, and certainly [many] are expecting to return to the industry . . . when they leave the position of

POLITICS OF NATIONAL HEALTH CARE REFORM

(continued from page 1)

"I am convinced that employer-based approach in its present form is useless and cannot be made to work," said Stark.

Gradison recalled that both he and Stark objected to the Pepper Commission's failure, in its September 1990 report, to say how its more than \$66 billion dollars a year in additional health care spending could be paid for. "Maybe we've been on the Ways and Means Committee too long, but our general view is that if you are going to recommend something you ought to pay for it."

Regarding the health insurance industry, Stark opined that it may not end up with a major role in the United States because "you guys are too expert at what you do"—an allusion to medical underwriting. If it is true that 80% of health care costs are generated by 20% of the population under 65, "I bet you could tell me what side of the head they part their hair on," Stark said jestingly. With underwriting practices that avoid insuring people with higher costs, the industry aggravates the problem of the uninsured, he said.

Proposed health care reforms that would ban medical underwriting and institute community rating might turn the insurance industry into bill payers, Stark said. On the other hand, he offered, "we might create a market of 200 million people for a new kind of supplemental insurance that might be very attractive. I would hope that that would be the compromise we would come to with the insurance industry." Δ

Special Supplement on Professionalism

Over the past few years, changes in the code of professional conduct, qualification standards (including continuing education requirements), standards of practice, and disciplinary procedures affecting Academy members have proceeded at a rapid, if not bewildering pace. The special subject supplement on professionalism, included in this mailing, is devoted to highlighting the thrust of these changes.

American Academy of Actuaries 1991 Annual Meeting

(Agenda in Brief)

Wednesday, September 25

OPENING RECEPTION

Thursday, September 26

ANNUAL BUSINESS MEETING

GENERAL SESSION

The Honorable Howard Metzenbaum
Insurance Company Solvency

The Honorable Fortney (Pete) Stark and Willis (Bill) Gradison, Jr.
A Democratic and a Republican Perspective on Health Care Reform

CONCURRENT PANEL SESSIONS

Pensions

Moderator: Larry Zimpleman

Panelists: Phyllis Borzi, House Education and Labor
Subcommittee on Labor-Management Relations
John Burke, Assistant Commissioner, Internal Revenue Service
Carolyn Smith, Joint Committee on Taxation

Health Insurance

Moderator: Harry Sutton

Panelists: Brad Kane, House Energy and Commerce
Subcommittee on Commerce, Consumer
Protection and Competitiveness
Bonnie Hogue, Senate Special Committee on Aging
Roy Ramthun, Senate Committee on Finance

Insurance Solvency Regulation

Moderator: John Harding

Moses Boyd, Senate Commerce, Science and
Transportation Subcommittee on Consumer
Mark Peavy, National Association of Insurance Commissioners
Gary Slaiman, Senate Judiciary Subcommittee on Antitrust,
Monopolies, and Business Rights
James Swenson, former Administrator, Oregon Division of Insurance

LUNCHEON SPEAKER

The Honorable Alan Simpson
An Overview of the 102nd Congress

OPEN FORUM COUNCIL MEETINGS

Casualty Practice Council

Chair: Academy Vice President Michael Walters

Health Practice Council

Chair: Academy Vice President Robert Dobson

Life Practice Council

Chair: Academy Vice President Stephen Radcliffe

Pension Practice Council

Chair: Academy Vice President Larry Zimpleman

Professionalism

Chair: Academy Vice President Richard Snader

1991 Annual Meeting: Breakout Sessions

Insurance Solvency Regulation

by E. Toni Mulder

One of the key authors of Senate Bill 1644, Gary Slaiman (counsel for the Senate Judiciary Subcommittee on Antitrust, Monopolies, and Business Rights), recapped much of what the bill's key sponsor, Senator Howard Metzenbaum, detailed in his morning speech.

The legislation would create at the federal level an Insurance Regulatory

Commission (IRC) consisting of five members appointed by the President. The bill provides for minimum standards for state regulation. Slaiman expects that the National Association of Insurance Commissioners (NAIC) would help to shape and frame what those standards should be. The IRC cannot take away the license of an insurer, but it can go to states and request action if it finds a company is not in good shape. Slaiman stated that the federal government does not want to be in the day-to-day regulation of the insurance business.

One of the twenty-three proposed minimum standards is a requirement for annual analysis of insurance companies by a qualified actuary. However, the draft bill does not contain a definition of a qualified actuary. Slaiman looks to the actuarial profession to provide the subcommittee with the definition.

Congress's Historical Interest

Moses Boyd, counsel for the Senate Commerce, Science, and Transportation Committee's Consumer Subcommittee, gave a brief history of Congress's involvement in insurance. The House—specifically the House Committee on Energy and Commerce Subcommittee on Oversight and Investigations—looked at insurance about four years ago and subsequently published the report "Failed Promises," also known as the Dingell Report. Senator Bryan, head of the Consumer Subcommittee, held oversight hearings in the 102nd Congress. It was recognized, even by some insurance industry groups, that there were weaknesses in the state regulatory system. The major conclusion of the Senate subcommittee was that regulators did not act quickly enough. The NAIC task force on insolvency and the certification program by states alleviated some of the concern. Then came Executive Life, Mutual Benefit, First Capital, and Fidelity Bankers Life.

Congress then decided to look more carefully at insurance regulation. In June, Senator Bryan added an amendment to the crime bill for federal penalties for insurance fraud, hoping to ensure that state regulators receive accurate information. Senator Dingell has a draft proposal on insurance regulation. Senator Metzenbaum's bill is in the Consumer Subcommittee. Boyd predicts that Congress will continue to look at insurer solvency for the next several years.

States' Regulatory Perspective

Mark Peavy, actuary for the NAIC, questioned the definition of "insurance" and "insurer" under Metzenbaum's bill and wondered how the bill's minimum standards would relate to HMOs. According to the draft bill, Peavy said, if a state program is certified, an insurer can automatically conduct business in another state. He said the bill does not

Jarvis Farley Service Award

The Academy has established, for the first time in its twenty-six-year history, a service award to commemorate one of its members. The Jarvis Farley Service Award is dedicated to the memory of Jarvis Farley, whose untiring committee volunteer work and devotion to the actuarial profession was truly exemplary.

Jarvis Farley began serving on various Academy committees in 1972. He was a member of the Committee on Financial Reporting Principles from 1972 to 1976, and he chaired that committee in 1973. Upon the establishment of the two financial reporting committees in 1975—one for life insurance, one for property/liability insurance—he provided leadership through the general committee for two years.

Jarvis was in the vanguard concerning continuing care retirement communities (CCRCs). When the Academy established its Committee on CCRCs, he both served that committee and had major responsibility for drafting the actuarial standards of practice on CCRCs. (With his wife, Elizabeth, Jarvis was a resident of the North Hill retirement community in Needham, Massachusetts.)

The Academy's committees are its lifeblood. The Executive Committee would like to honor members, who, like Jarvis Farley have provided exemplary volunteer service to the Academy. Eligible nominees include Academy members, past and present committee members (including ASB members and committee members), committee chairpersons, and directors of the Academy. However, officers serving present terms of service are ineligible.

The Jarvis Farley Service Award will be given each year that there is a deserving recipient whose record of dedicated service meets the Academy's criteria. Each awardee will receive a replica of the engraved silver bowl (the perpetual award) exhibited in the Academy office, as well as having his or her name inscribed on the latter.

Elizabeth Farley attended this year's Annual Meeting and received a replica of the award. She reminisced about her late husband's dedication to the profession. In closing, she remarked, "I just want to thank you very much for honoring him in this way. I was very moved when I heard about it, and—I was just going to say—I wish he knew. But how do we know? Maybe he does."

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Current Pension Issues

by Christine Nickerson

The panel for the Annual Meeting pension breakout session included Carolyn Smith, legislation counsel for the Joint Committee on Taxation; Phyllis Borzi, counsel for pensions with the House Subcommittee on Labor-Management Relations; and John Burke, Assistant Commissioner for Employee Plans and Exempt Organizations, Internal Revenue Service (IRS). The panelists' discussion focused on proposed pension simplification bills, insurance-provided annuities for terminated plans, and the IRS audit program.

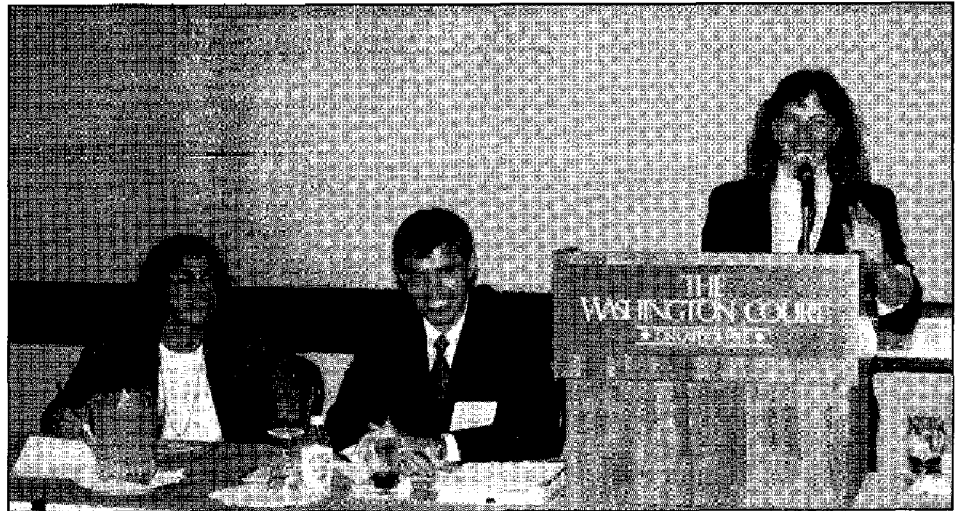
Pension Tax Simplification

Carolyn Smith described the basic issues that various pension simplification bills are attempting to address. These issues are taxation of distributions, small-business access, nondiscrimination rules, and miscellaneous changes, such as simplifying the definition of "highly compensated employee."

Smith said that all the bills attempt to clarify what portion of a distribution is taxable, liberalize rollovers, and simplify the complex basis-recovery rules. The most controversial issue in the distribution area is the special tax treatment for averaging lump-sum distributions. The drafters of the simplification bills do not believe that such income should be untaxed, nor that lump-sum distributions should be encouraged, Smith said. However, she added, there is a fairness issue of taking away a previously acceptable tax-planning device.

Access to pension plans has been addressed primarily by extending the option of establishing salary-reduction Simplified Employee Plans (SEPs) to employers with up to 100 employees. Nondiscrimination rules would be relaxed through a design-based approach to testing. Smith noted that the government wants benefits to go to the rank and file, and the design-based approach may not encourage this outcome.

Commenting on the possibility of congressional action on pension simplification, Smith said that such action is unlikely because there will probably not be any tax bill this year.



Annuities of Terminated Plans

Who bears the ultimate responsibility for paying a terminated pension plan's annuities when the insurance company holding those annuities becomes insolvent? This is a difficult issue, according to Phyllis Borzi. She said that the framers of the Employee Retirement Income Security Act probably never thought an insurance company would become insolvent. Borzi described recent hearings on the issue and said the hearings left members of Congress with the clear impression that the problem is not over yet and that other companies may fail.

Borzi discussed the impact of such failures on annuitants. When the state of California took control of Executive Life, one of the state's first actions was to reduce the amounts being paid to annuitants by 30%. Yet, it is unlikely that annuitants can ask a supermarket checker to reduce their grocery bill by 30%, she said.

Any attempt to address this problem must consider how to make the system better and how to help retirees, said Borzi. The Pension Benefit Guaranty Corporation (PBGC) has taken the position that it is not responsible for guaranteeing benefits if the defined benefit plan, upon termination, has sufficient assets to pay all benefits, has properly computed its benefit obligations, and has purchased annuities from an insurer. Borzi does not support this position; she believes that the PBGC does have ultimate responsibility.

Some options currently being discussed to deal with the annuities issue include federal regulation of the insurance industry, making the PBGC the insurer of last resort, having insurers

that sell annuities finance a national guaranty system for such annuities, and making the employer liable for benefits in the case of an insurance company insolvency. Borzi said that all these approaches seem in one way or another to lead back to the PBGC. It is hard to predict what direction Congress will take, she said.

IRS Audit Program

John Burke spoke to the group about the IRS examination program. He said that when the IRS initiated a small-plan actuarial audit program for qualified defined benefit plans, the abuse focused on was overfunding. Burke acknowledged that, in addressing this problem, the IRS might have gone too far. He believes there is a need to balance enforcement better.

In coming months, the agency will move from the small plan audit program to something different, Burke said. He noted that a recent General Accounting Office report criticized the IRS for focusing on overfunding and neglecting problems such as underfunding. Burke said that as more aspects of plans are examined, examiners will need more training to ensure that they are qualified for the work they undertake. New areas of focus will include looking at the plan balance sheets to consider the true market value of investments. Also, there may be abuse problems having to do with SEPs because there has been no enforcement in this area, he said.

Asked about the chance of a more generous version of the audit resolutions program, Burke said it would not be sweetened. It is "a fair and liberal offer," he said.

Nickerson is director of the standards program.

Actuaries Air Views on Discounting Standard at ASB Hearing



ASB Hearing Panel: Michael J. Miller, Gary Corbett, Walter N. Miller, Jack M. Turnquist, James A. Faber, P. Adger Williams.

by Alan Kennedy

Seven of nine actuarial speakers at a September 25 public hearing voiced support for the issuance of an actuarial standard of practice on discounting of loss reserves. There was some sentiment for delaying it until a standard could be developed on risk margins, which were recognized as unavoidably linked to discounting, but a risk-margin standard could be years away from formulation, those at the hearing were told.

The hearing was called by the Actuarial Standards Board (ASB) on request, after letters of opposition were received to the second exposure draft of a proposed standard titled *Discounting of Property and Casualty Loss and Loss Adjustment Expense Reserves*. It was the ASB's second public hearing, the first having been held on a proposed pension shutdown standard last March.

One reason cited in the letters and by one of the speakers for opposing the discounting standard was that it could by its very publication encourage the inappropriate use of discounting, though any intention to promote discounting was disclaimed in the standard. "This standard would be seen by company management and accountants as *de facto* endorsement of discounting," declared Daniel K. Lyons, speaking for the actuaries at General Reinsurance Corp.

However, while reiterating the opposition of the National Association

of Insurance Commissioners (NAIC) to discounting in statutory statements, Robert J. Gossrow, casualty actuary for the Illinois Department of Insurance, said the NAIC was not opposed to the promulgation of the proposed standard. He suggested only that the document might benefit by adding a statement to "discourage discounting in statutory financial reporting."

Indeed, most proponents of the standard appeared to view the need for actuarial guidance on how to do discounting as overriding any concern about appearing to encourage the practice. If the ASB does not promulgate a standard, "it is likely that others will step in and state what actuaries should do," warned Harold J. Brownlee, a consulting actuary and recent past president of the Academy. He mentioned the Financial Accounting Standards Board (FASB) and insurance regulators as among the "others." Brownlee also suggested that the standard could well be broadened to apply to pensions as well as property/casualty reserves.

FASB has in fact taken two recent initiatives that may lead to allowing discounting of reserves under generally accepted accounting principles (GAAP), said Ralph S. Blanchard III, speaking for actuaries involved with the issue at Aetna Life & Casualty. One is an exposure draft titled "Disclosures about Market Value of Financial Instruments,"

which Blanchard said "may force discounting of liabilities as a reaction to forced market valuing of assets." The other FASB initiative is a discussion memorandum, "Present Value-Based Measurements in Accounting." "Discounting for GAAP may be only several years away," said Blanchard, and for this and other reasons, the ASB should have a standard.

Support for an actuarial standard on discounting also came from Alfred O. Weller, chairperson of the Casualty Issues Committee of the Conference of Consulting Actuaries. The present draft, which Weller helped to develop as a former member of the ASB's Casualty Subcommittee on Loss Reserving, should be adopted, he said, because it requires documentation of the interest rate assumption and the method used, and consistency among assumptions.

Representing the Casualty Actuarial Society (CAS) Committee on Reserves, Neil A. Bethel said the committee does not view the proposed standard as an endorsement of loss reserve discounting, but feels strongly that the standard "must include a discussion of the relationship of loss reserve discounting and the amount of risk margin that may be present in a reserve, either implicitly or explicitly determined."

Bethel said his committee has invited a research proposal on methods of presenting risk margins in financial reporting, and the CAS Committee on the Theory of Risk has a prize-paper program on the same subject. The results of these initiatives will not be out until perhaps early 1993, however, and if the ASB delayed its discounting standard "until generally accepted actuarial methods of determining risk margins were formulated," it might turn out to be a long delay, he suggested.

But the chairperson of the Academy Committee on Property and Liability Financial Reporting, David G. Hartman, voiced a personal preference for having a standard on risk margins issued before a standard on loss reserve discounting. Hartman relayed to the ASB hearing a statement his committee presented to FASB on July 9, 1991, in response to the FASB discussion memorandum on present-value-based measurements. The essence of his committee's statement, he summarized, is that "value-based measurements can be applied to property/liability insurance if the interest rate is risk-adjusted."

Joining Brownlee in urging that the standard be broadened beyond the bounds of property/casualty loss reserving was Jeffrey Petertil, another

consulting actuary. "Discount rates and present values are a basic part of most actuarial work," he said in a statement. "Rules which fit for casualty work should also fit other insurance and benefit work. In addition, there is a growing need to place actuarial work in the larger context of financial and economic calculations which use risk-adjusted interest rates to convey market perceptions of risk."

Walter N. Miller, conducting the hearing as chairperson of the ASB, replied that the board "agrees that standards should be as broad as feasible."

The final speaker of the day disagreed that a standard was needed. In fact, Thomas J. Kozik, a senior research actuary at Allstate, declared that "discounting is too trivial a task to glorify with a standard. It is analogous to having a standard for computing compound interest." Kozik also took issue with the exposure draft, saying that it was inconsistent with financial theory.

About twenty persons attended the hearing in addition to the hearing panel, which consisted of three other members of the ASB, Gary Corbett, Jack M. Turnquist, and P. Adger Williams; Michael J. Miller, chairperson of the ASB Casualty Committee, and James A. Faber, chairperson of its Subcommittee on Loss Reserving.

The reserving subcommittee, the parent Casualty Committee, and the ASB are all expected to play roles in deciding what steps are next.

Kennedy is standards editor for the Actuarial Standards Board.

Simpson Leaves Them Laughing at Annual Meeting Luncheon

by Ken Krehbiel

Hurrying from Capitol Hill to a hotel and back can take its toll. One of the first things Senator Alan Simpson (D-WY) told the luncheon gathering of attendees at the Academy Annual Meeting was, "Yes, I did sleep in this suit."

Simpson then demonstrated why he has the reputation as one of Capitol Hill's favorite and most entertaining speakers. He peppered his luncheon address with humorous anecdotes and witty one-liners, but he also gave his audience some food for thought on the health care crisis, which he called "bigger than bear meat. You know what bear meat is, don't you? It's something that the more you chew, the bigger it gets."

The health care crisis won't be easily resolved, according to Simpson. He told the audience of actuaries, "You're going to have to guide us, especially if we get into health care." Part of the problem in health care now, Simpson said, is that "there are plenty of people thriving on chaos. \$673 billion per year. That's chaos."

To give some idea of how large a billion is, he explained that a billion seconds ago Don Larsen pitched his perfect game (in the 1956 World Series), a billion minutes ago, Hannibal and his minions were crossing the Alps (218 B.C.), and a billion hours ago, the world was a large solid rock.

Although people are appalled by the cost of health care, "If you look at the possibilities," Simpson says, "they really don't say much about it."

After Simpson's speech, a question from Academy President Harry Garber returned to the health care issue. As for the prospects of legislative reform of the health care system, the Senator said, "We will have some proposal," which he then expects people to "tear apart."

Simpson told the actuaries in attendance that Congress relies on them for truthful answers and not just the ones members want. He said, "All you have to do to get the right figures is just wait." Amid a ripple of laughter, he said, "That's the truth. That's not a cynical statement, that's true."

Another difficult balancing act any legislator must perform is juggling special interests and handling the pressure of special-interest groups. Through the years, it's something Simpson has had plenty of experience doing. He says interest groups "explain and complain," but in fiercely protecting their own interests, they don't say, "We're willing to pitch in." That's the part I never hear."

But special interests, politics, and issues aside, the best speakers on the dinner circuit still rely heavily on humor. And sometimes Simpson is his own best target. He told a story about buying a fishing license. He and the woman selling the license didn't see eye-to-eye on an issue. Their discussion dragged on, and Simpson started to wonder if he was ever going to get to fish. Apparently, their conversation was as exasperating for her as it was for him, because after he left, Simpson noticed on his license that for hair color, she had written "glossy." (Simpson is balding.)

As he left, Simpson fielded one last, fairly technical, question and his response quickly evolved into a self-deprecating admission: "A man should sometimes just say, 'I don't know.'"

"I don't know."

Simpson's speech was telecast nationwide in its entirety that night on C-SPAN.



Senator Simpson chats with Academy President Harry Garber.

Krehbiel is public relations specialist for the Academy.

Forecast 2000 Actuaries Blitz Pacific Northwest

by Ken Krehbiel

The busiest and most productive media tour of the 1991 *Forecast 2000* public relations campaign took Academy Executive Vice President Jim Murphy and Rob Brown, immediate past president of the Canadian Institute of Actuaries, to the Pacific Northwest October 1-4. The week-long tour began in Portland, proceeded to Seattle, and finished in Vancouver.

Environmental risk, specifically how actuaries are becoming more involved in assessing environmental risks and helping businesses plan for them, was the subject of the media appearances. Brown and Murphy had twelve bookings in all, giving interviews to reporters for stories in newspapers and print media, and making appearances as guests on radio public-affairs programs.

Wednesday's activity in Portland landed a feature story with photos of Brown and Murphy in the *Portland Oregonian*. Public affairs programs on three Portland radio stations also had Brown and Murphy as guests.

The PR foursome, which included Academy Director of Public Relations Erich Parker and Edelman Public Relations Senior Account Supervisor Elizabeth Kelley, landed three more radio interviews on a busy day in Seattle. A produced piece on KISW-FM included the actuarial perspective on environmental issues along with the celebrity activist views of musicians Sting, Bonnie Raitt, and Bruce Hornsby.

On the last day, in Vancouver, British Columbia, Brown and Murphy met with reporters from two daily newspapers, including the *Vancouver Sun*, and made three more radio appearances. Because the Canadian Institute of Actuaries cosponsors *Forecast 2000*, each year's program has included a media tour stop or press conference in Canada.

Forecast 2000 began in 1989 to celebrate the centennial of the actuarial profession in North America and to look toward the year 2000 to publicize how actuaries would serve society in the next century. The program is cosponsored by the six major North American actuarial organizations. The main elements of this year's program were three media tours, ten one-minute produced commentaries televised on *Nation's Business Today* (aired on cable's ESPN), and general press publicity of original research published in *Contingencies* magazine. There were also print media profiles featuring actuaries in nontraditional practices and data and graphics distributed to print media on the relative risks of athletic and leisure activities.

LETTERS TO THE EDITOR

(continued from page 3)

work is somehow above criticism or that informed people from outside the profession have no right to question our judgment. Many of us, including the chief actuary of HCFA, work for nonactuaries. Sometimes we are wrong and our bosses right. The case of the HI actuarial certification may be an example of that.

Bruce D. Schobel
New York, New York

Flip Side of the Coin

Roland E. King, chief actuary for the Health Care Financing Administration, discusses in the August *Update* letters column why he was not able to provide

an unqualified actuarial opinion in the 1991 Hospital Insurance (HI) Trust Fund report. He also brings out why he believes that the statement of the two public trustees that his actuarial certification was not only incorrect, but improper was "an unprecedented affront to the professionalism of actuaries." In the September *Update*, Gregory J. Savord, one of Mr. King's staff, strongly backs up his viewpoint.

I concur that actuaries should have independence of professional action, but I believe that there are limits to independence. This is the same as with freedom of speech, which does not extend to crying "Fire!" in a crowded theater as a prank. Further, we should recognize that other professions have a competence in some areas in which we deal, such as real-wage growth. If the staffs of the cabinet officials who are trustees come up with different

assumptions as to future trends (as well as interpretations of past trends) that the trustees adopt, this does not reflect dishonorably on the actuary's professionalism as long as he or she can accept the results as being in the range of reasonableness. After all, in connection with private pension plans, actuaries often revise their assumptions at the request of the plan sponsor if the resulting elements are still "reasonable."

In the field of past real-wage changes, one can get almost any answer that one wants by choosing the "right" starting and ending years. Mr. King's statement of actuarial opinion asserts that "There has been virtually no net increase in real earnings during the last 22 years." Using the series of *estimated* real nationwide earnings (wages and self-employment income) ending with 1989 (the latest final data available), compound annual rates of change are as follows: 1967-89, +0.18%; 1951-89, +1.11%; 1973-89, -0.39%; and 1982-89, +1.56%. So, take your choice! The ultimate rate of +1.06% used by the trustees in Alternative II (intermediate) assumptions—based on 5.1% annual earnings increase and 4.0% CPI rises—does not seem unreasonable.

As to the method of summarizing the actuarial balance of the program, three actuarial committees or panels have expressed the belief that the present-value method (as used by the trustees and the chief actuary of the Social Security Administration) is appropriate. Two of the three groups stated that Mr. King's modified average-cost method also had value, whereas the other groups unequivocally came out for the present-value method. And it is important to note that the results of using the latter, which produces about the same picture of the financial insolvency of the HI program over the long run, are presented in the HI Trustees Report.

Finally, there is the "other side of the coin." Based on Mr. King's views on the above two points, there is a challenge to the professional ability and judgment of the chief actuary of the Social Security Administration, who did not qualify his actuarial opinion because of the two elements of real-wage changes and the present-value method of summarizing actuarial balance (or, for that matter, for any other reason).

Robert J. Myers
Silver Spring, Maryland

INSURANCE SOLVENCY REGULATION

(continued from page 6)

address rate regulation, form regulation, and market conduct. He questioned how much all of this will cost, who will pay, and if there will be a benefit to the payer.

Crisis of Confidence

Jim Swenson, former administrator for the Oregon Division of Insurance, acknowledged a "crisis of confidence" in the insurance industry. He pointed out that the NAIC has stepped up the pace of addressing solvency issues. The industry is trying to balance affordability and availability of insurance with solvency, he said.

Senator Metzenbaum, who addressed all meeting attendees earlier in the day, had cited shortfalls to the regulatory system. Swenson sees these as challenges. He pointed out that the voluntary NAIC process needs more time to be worked out and should be given more time. The NAIC has added additional qualified examiners and strengthened the central NAIC office, where staff has almost doubled. He acknowledged there may be a federal role in the examination of offshore reinsurers.

NAIC's Positive Steps

Swenson also noted that the NAIC already requires an annual actuarial certification on all companies, both property/casualty and life/health. He pointed to standards of practice, disciplinary procedures, and the valuation actuary concept (Oregon was one of the first states to adopt this legislation) as other positive steps.

Swenson was pleased to note that the federal legislation proposes to work closely with the state regulators and not undermine the role of the commissioners. He noted that the NAIC is addressing many of the concerns of the federal legislators and questioned whether legislators might be under even more pressure than the state regulators.

G. Patrick Byrnes is a consulting actuary and editor of The Update.

Approval to Sign Casualty Loss Reserve Opinions

Members who intend to sign 1991 casualty loss reserve opinions need to be approved as qualified by the Academy Casualty Practice Council, unless they are also members of the Casualty Actuarial Society, or unless they received approval last year.

In June 1990, the National Association of Insurance Commissioners (NAIC) adopted a requirement that property/casualty insurers in all states submit loss reserve opinions signed by a "qualified actuary." The NAIC defined a "qualified actuary" as a person who is either a member in good standing of the Casualty Actuarial Society, a member in good standing of the Academy who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council, or a person who has otherwise demonstrated competency in loss reserve evaluation to the satisfaction of the insurance regulator in the insurer's domiciliary state.

For the 1990 annual statement year, twenty-eight applications were requested, twenty-two were sent in, and nineteen were approved for various lines.

Academy members whose qualifications were reviewed and approved by the Casualty Practice Council last year need not reapply for approval this year. However, those members who plan to seek approval from the Casualty Practice Council for the first time need to call the Academy for the latest forms and fill them out and send them in, along with a letter attesting to alternative education attainment. The review process can take a month or longer, so applicants should request the forms promptly.



The twenty-fifth anniversary of the American Society of Pension Actuaries (ASPA) was celebrated in Washington, D.C., September 29 to October 2. Presidents or presidents-elect of the organizations represented on the Council of Presidents attended the opening session, bearing gifts. Above, ASPA President G. Patrick Byrnes (left) receives an engraved tray from Academy President Harry Garber.

1991 Annual Meeting Report: Business Session

President Mavis A. Walters: I would like to call to order the 26th Annual Meeting of the American Academy of Actuaries. Welcome to you all.

This past year has been a very busy and exciting one for the Academy. The issues confronting the actuarial profession have become increasingly complex, and we are very fortunate to have so many dedicated members who are willing to donate their time and effort to Academy activities.

While we have a very fine staff headed by Jim Murphy, the Academy could accomplish very little without the hard work of our committee volunteers. They really are the heart and soul of the Academy, and without their professional expertise the Academy would be but an empty shell.

I believe we have put in place a very fine, workable structure to help us deal with important public policy issues. The Academy is well positioned to deal with all its audiences, whether they be members of Congress, representatives of the states, the National Association of Insurance Commissioners (NAIC), or the media. Yet without substantive positions developed by the experienced, knowledgeable professionals, the Academy simply couldn't be effective. I'm very grateful to all those Academy members who have worked so hard during the past year.

One of the structural changes that I believe has worked very well is the

establishment of the four practice councils, one each for casualty, health, life, and pension practice. These practice councils, each chaired by an Academy vice president, help to plan, coordinate, and monitor the activities of the various committees in their practice area. In the future, we will be looking to the practice councils to take a more active role in the public relations area as well.

For taking on the assignment of running the practice councils, I want to thank our four vice presidents during the past year as well as all the committee chairpersons who have served on those practice councils.

Another important change made in the past year was the decision to appoint the president and/or the president-elect of each of the other U.S. actuarial organizations to the Academy Board of Directors. I believe that is going to be very helpful in strengthening the ties between the other organizations and the Academy, and it certainly is going to promote an ecumenical spirit among all the organizations.

I would like to recognize some of the presidents and presidents-elect of the other organizations: Mike Toothman, president-elect of the Casualty Actuarial Society; Ray Cole, president of the Conference of Consulting Actuaries; Don Sondergeld, president-elect for the Society of Actuaries; and Ruth Frew, president-elect for the American Society

of Pension Actuaries.

And from the Actuarial Standards Board, the incoming chairperson, Jack Turnquist is here.

Thank you. Now it is time to ask Jim MacGinnitie to come forward and give a report from the Nominating Committee.

Past President W. James MacGinnitie: Good morning. The president-elect of the Academy, Harry Garber, will assume the job of president at the conclusion of this Annual Meeting.

Yesterday the Board of Directors, in accordance with the bylaws, elected the slate of officers for the coming year. And I am pleased to report that our new president-elect is John Harding. We have three new vice presidents: Larry Zimpleman for pensions, Steve Radcliffe for life insurance, Dick Snader for professional affairs.

Tom Levy, our hard-working treasurer, will be given the duties of secretary in addition this coming year, as a result of a change to the bylaws.

We are now at the point in the meeting where we elect the directors for the coming year. The nominating committee is pleased to submit the nominations for six individuals for three-year terms as directors of the Academy: Jack Byrne, Bob Cossrow, Walter Miller, Ken Porter, Dave Flynn, and Bob Guarnara.

In addition, we have two one-year terms that need to be filled because of the election of vice presidents Steve Radcliffe and Larry Zimpleman. The Nominating Committee would like to place nominations for those two spots: Ruth Frew and Walter Rugland.

President Walters: Thank you, Jim, for your report.

Are there any other nominations from the floor? Hearing none, may we have a motion to elect the candidates selected by the nominating committee?

A Participant: So moved.

Ms. Walters: Second?

A Participant: I second.

Ms. Walters: All in favor please say "Aye."

[Simultaneous ayes.]

Ms. Walters: Opposed? [No response.] Thank you. And congratulations to our new board members. Thank you very much, Jim. And now it gives me great,



Harry Garber is handed the gavel by outgoing president, Mavis A. Walters.

great pleasure to pass the gavel of office to our new president, Harry Garber. I know he is going to be an outstanding president. It has been an absolute delight working with him during the year, and I know he is going to do a terrific job. Congratulations, Harry, and good luck.

President Harry Garber: Thank you. I will be mercifully brief, because Senator Metzenbaum is on the way here. I just want to say that I am very honored to be selected for this office. It is not an office I sought or expected, but I cherish it; it is a challenge that I accept and look forward to.

The Academy is surely growing in purpose and effectiveness. That is really attributable to the leadership over its whole term, but particularly to the leaders over the past few years. Mavis has done a great job during her term. I think we ought to give her a round of applause. [Applause.]

As Mavis said, the Academy's effectiveness cannot be attributed to the leadership alone, but to everyone who has worked for the Academy, either on committees or in other roles. And without all of you, we wouldn't get the job done. I will do my best to continue in this tradition of growth in effectiveness, and I know I can count on all of you as well.

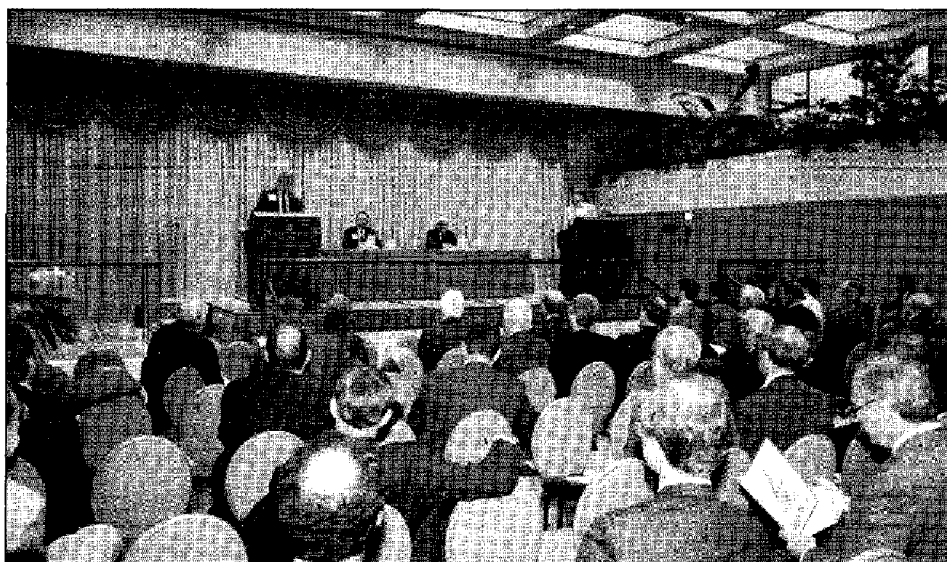
Three topics covered in today's program exemplify the challenges that are ahead for us: insurer solvency, health care, and pensions. These are industries and institutions that have developed largely in the private sector in this country, and which have served hundreds of millions of Americans.

Clearly, these are the institutions or industries in which members of our profession have been most involved. So, we have a great interest in their wellbeing. At this point, these industries are under great pressure as a result of social and economic changes.

A couple of decades ago, our profession might have stood around and watched all these developments with detached interest. Today, through the Academy (and that means you and me), we will have an active role in establishing public policy and in strengthening these institutions that are so important to our nation and to our profession.

Just yesterday, the board established a task force — a "blue ribbon" task force under the leadership of John Harding, our new president-elect to look into the area of insurer solvency.

The task force will define the issues



essentially, but will then look to the other institutions, the committees of the Academy, and probably to the CAS and SOA to provide a lot of work on these issues. Insurer solvency issues are critical to our profession, and we look to John to provide great leadership for that effort.

It will be a challenging year, but the fun of life is in challenge. At the end of next year, the profession will have moved a few more steps ahead. And that will be due to me in part, but principally to all of you.

So I look forward to working with you. And at this point I will turn the program over to Jim Murphy.

Executive Vice President James Murphy: Thank you, Harry. And I too look forward to working with you over the coming year, as we have begun to work together this year. I think we have a very important year ahead of us.

If Jack Morehead were here and writing a sequel to *Our Yesterdays*, I wonder how he might characterize the last three years. I have a chapter heading to recommend: "The Spread of Professionalism."

When I took the post of executive vice president, about three years ago, the professionalism movement within the actuarial profession had gained some real ground.

In 1988, Academy members had voted to establish the Actuarial Standards Board. And the Joint Task Force on Strengthening the Actuarial Profession had just made its initial recommendations. In the past three years, the professionalism movement has not slowed down a bit.

The Actuarial Standards Board has

drafted, exposed, and promulgated eighteen actuarial standards of practice, and as many as fifteen more are in the pipeline. And, as far as professional standards and discipline are concerned, the Academy has worked in concert with the other organizations, and we now have some key structures in place.

For example, the Joint Committee on the Uniform Code of Professional Conduct has drafted a model code of conduct, which was exposed to all of the members in April of this year. At the board meeting yesterday, this code was adopted for the Academy.

Each of the other organizations now has the opportunity to adopt the code as it is, or tailor it to their particular organization.

And the Actuarial Board for Counseling and Discipline (ABCD), formally established by your vote this summer, will now be responsible for reviewing cases where an actuary's professionalism has been called into question. Counseling and recommending disciplinary action where appropriate will be the ABCD's distinct charge.

These developments are important milestones, and Jack Morehead could probably write a whole chapter on them. But the professionalism movement isn't just one chapter in the history of the actuarial profession. Its roots go all the way back to the founding of our profession in North America.

And certainly, our efforts to strengthen professionalism today will benefit and be the mainstay of our organization and its health in the future. Of course, professionalism is not simply

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Casualty Loss Reserve Seminar Report

Solvency Viewpoints: State and Federal

by Michael A. McMurray

The Casualty Loss Reserve Seminar general session on Solvency Viewpoints, September 22, provoked a lively exchange among the panelists regarding state versus federal regulation of insurance carrier solvency. The panelists included John H. Snyder, vice president of A.M. Best Company; Gary Slaiman, majority counsel for the Senate Judiciary Subcommittee on Antitrust Monopolies, and Business Rights; and William H. McCartney, insurance commissioner for the state of Nebraska.

Snyder set the stage by summarizing the results of a study of property/casualty company insolvencies recently published by A.M. Best. This study focused on the 372 property/casualty insurance company insolvencies occurring since 1969.

The A.M. Best study concluded that the property/casualty insurance industry fared better than most other financial industries in terms of company failures. However, insurers should be held to a higher standard given the role they play in society, said Snyder.

The study also revealed that the frequency of insolvencies tended to vary inversely with state regulatory budgets and with the age of the company. Stock companies had a much greater insolvency frequency than did mutuals. In the 1970s, insolvencies were most frequent among personal-lines carriers; whereas, the 1980s were the era of commercial-lines carrier failures.

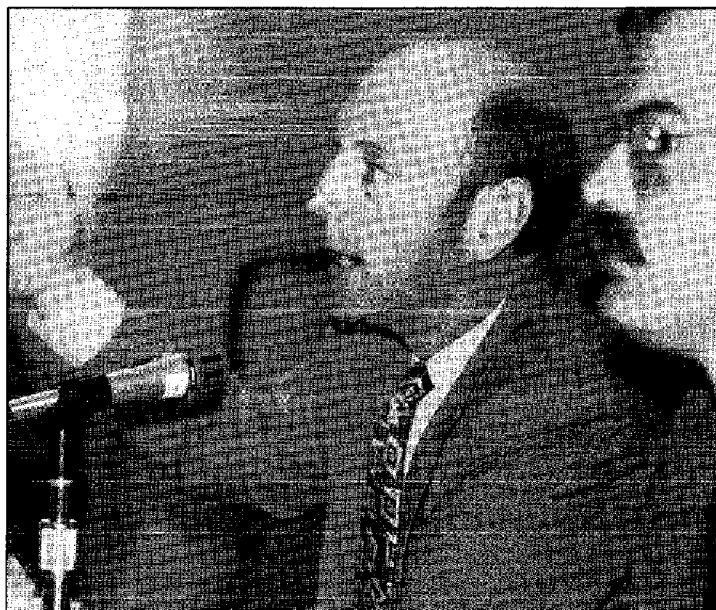
Snyder identified the major reason for company insolvencies as inadequate reserves, inadequate prices, rapid growth and reinsurance failures. He also cited fraud, but noted that white-collar crime did not appear to be the same problem for insurers as it has been for the savings and loan industry.

Next, Gary Slaiman summarized the key aspects of the Metzenbaum bill calling for federal oversight of state

regulation of insurance. He noted that this new legislation was prompted primarily by problems in the life insurance sector. In Slaiman's view, there is a crisis in confidence in insurance regulation. He stated that the quality of state regulation is not uniformly good and that federal oversight can address this issue.

The specific bill that he described has the following characteristics:

- It would establish a federal insurance regulatory commission to accredit state insurance departments who meet minimum standards.
- The minimum standards would address capital requirements, consumer disclosure, and reserve setting—



Commissioner McCartney and Counsel Slaiman share mike.

including statements of opinion from qualified actuaries.

- Minimum insurance department resource requirements, including actuarial support, would be set.
- Reinsurance would be regulated at the federal level.
- A national guaranty fund would be established.

The proposed guaranty fund would be prefunded through company assessments and would preempt state guaranty funds. It would oversee liquidations on a national basis and could also be used to assist carriers who could survive if given a prudent cash infusion.

McCartney offered a rebuttal to the expressed need for and the advisability of federal solvency regulation. He noted that the content of the proposed federal bills is not significantly different from that of the National Association of Insurance Commissioners' (NAIC) model laws drafted several years ago. He further doubted that the federal government would be any more effective than the NAIC in dictating uniformity among states. From his standpoint, the federal government can only provide another layer of bureaucracy to insurance regulation, not meaningful improvement.

McCartney did admit that the state guaranty fund structure could be improved. In particular, he cited the need for a prefunding mechanism whereby assessments would be based on the relative riskiness of each carrier's underwriting and investment portfolios. He did warn that the existence of guaranty fund assets could entice raiding by governmental entities to finance non-insurance obligations. He thought that this would be a special concern for a national guaranty fund, given the federal government's track record with Social Security and Medicare.

In conclusion, he stated that federal intervention would be counterproductive and further impede effective insurance regulation. He encouraged Congress to look instead to the NAIC for regulatory improvements and to support those efforts.

In response to a question from the audience, McCartney stated that it was not always in the public and policyholders' best interests to call for any early liquidation of a troubled company. He did indicate that the NAIC's risk-based-capital working groups are working to better discriminate between companies that can be rehabilitated and those that can't.

Responding to the same question, Slaiman cited congressional findings that companies have not been stopped fast enough in the past. He offered Executive Life Insurance Company as a recent example.

McMurray is a consulting actuary with Millman & Robertson.

FASB's Dictums on Discounting

Jeffrey P. Kadison

A session titled "New Developments in FASB's Position on Discounting" was held at the Casualty Loss Reserve Seminar. The session focused on the Financial Accounting Standards Board's (FASB) discussion memorandum titled "Present Value-Based Measurements in Accounting," issued in December 1990 and the subject of public hearings held in August 1991. (See Stephen Kellison's article in the February 1991 *Actuarial Update*.) Panelists were Wayne Upton (project manager for the FASB) and Allan Kaufman (a consulting actuary with Milliman & Robertson). The panel was moderated by Bertram A. Horowitz.

Upton discussed the five factors that prompted FASB to address the issue of present-value measurements:

1. High interest rates have increased the importance of investment income in the assessment of an insurer's performance.
2. Distinctions between classes of assets and liabilities (monetary and non-monetary) may not be as relevant as they once were.
3. The representational faithfulness of financial reporting that does not reflect present-value-based measurements has been questioned.
4. The implementation of present-value-based measurement varies considerably among accounting pronouncements.
5. FASB has relied on recent studies by other organizations as a foundation on which to build.

The reflection of present values has been opposed by some who argue that, since the amount and timing of future cash flows are subject to considerable uncertainty, accounting standards should ignore the time value of money. This argument stresses reliability of the measurement over the relevance of the estimate. (Upton implies that the present-value-based measurement is more relevant.)

Advocates of present-value-based measurement focus on four issues:

1. the future events to be included in the cash flow estimates;
2. the extent to which joint inputs, interaction and grouping may affect the estimates;

3. the adjustments to be made for risk, if any; and
4. the method of selecting the interest rate.

The issue of adjusting for risk has raised the most concern. Accounting procedures assume that observable marketplace measurements reflect risk.

FASB has received approximately 120 responses to the discussion memorandum. The notion of a risk adjustment elicited the most interesting comments. Some respondents believe that any consideration of risk should be prohibited, citing FASB Statement of Financial Accounting Standards No. 5 and its prohibition of contingency reserves. Others stated that the interest rate selected should reflect risk. Still

others, including many actuaries, advocated a systematic approach to a risk-reflecting process or parameter risk.

Upton also expressed concern that some respondents believe that the use of present-value measurements should not proceed until the question of risk is resolved. This suggests that pensions, other postretirement benefits, and life insurance should all use undiscounted measurements. Despite the imperfections of these measurements, their relevance is greatly enhanced when financial statements are presented on a present value basis.

FASB's next steps have not been discussed to date. Upton believes that the discussion memorandum should address problems of present-value-based measurement in a general sense before considering specific industry applications. Any resolution to the issue does not appear to be imminent.

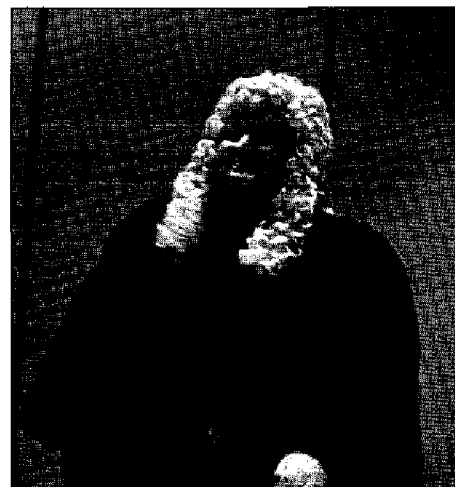
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Professional Standards on the Witness Stand

by David S. Powell

The Casualty Loss Reserve Seminar included a presentation on professional standards. Instead of the customary panel discussion, the presentation took the form of a mock trial. A hypothetical set of facts was introduced concerning an insurance company that had become insolvent. The insolvency was due, in large part, to a misperception of the insurer's past profitability. The misperception was due to an allegedly improper reserve review performed by a consulting actuary. The reserve review was based upon erroneous data that the plaintiff claims should have been detected if the actuaries involved had adequately performed their functions. The facts did not include any blatant actuarial errors, but rather a series of "shortcuts," file documentation problems, and less than perfect adherence to published standards.

The presentation consisted of the cross examination of the actuary (me) by the plaintiff's attorney, (Walter Bardenwerper, who graciously agreed to step out of his customary role as general counsel for the Wyatt Company to appear on the plaintiff's side of the courtroom).



Judge Roxanne Roxannadanna

The cross examination demonstrated how a plaintiff's attorney can create the appearance of ineptitude by exploiting seemingly innocuous departures from standards, lack of adequate file documentation, extraneous file material and even the qualifications of people working on mundane tasks.

A special guest appearance was made by the Honorable Judge Roxanne Roxannadanna (Jane Taylor) visiting from an earlier thespian effort, "Cut My Rate," a musical produced last year by the Casualty Actuarial Society.

Powell is an actuary with Tillinghast/Towers Perrin in Dallas.

BUSINESS SESSION*(continued from page 13)*

accountability to minimum standards. It is spirited striving for excellence and heartfelt commitment to one's profession.

Professionalism has many faces within the Academy. In three short years [since the ASB was established], nearly 200 members have contributed time and considerable effort to ASB standard writing. Easily 200 more have actively drafted public statements or given testimony to public policy makers.

I estimate that all together committee members donated approximately 8,000 hours to this work last year. Certainly we can be proud that so many of our members are actively involved in professional activities with the Academy, the Actuarial Standards Board, and the other membership organizations as well.

This year, the Academy's Board of Directors decided that an award should be established to honor volunteers who are truly extraordinary in their service to the Academy and the profession. This idea came about because we wanted to honor one such truly extraordinary member of our profession who passed away this summer, Jarvis Farley. Jarvis was a fellow of the Casualty Actuarial Society since 1940, and a charter member of the Academy. He had served on Academy committees since 1972. He had been active in the standards movement from its beginning. Jarvis epitomized the truly committed volunteer.

We honor him this year by setting up this award. In future years we will honor individuals who reflect a similar spirit of service, by awarding them the Jarvis Farley Service Award.

We are honored to have with us today Mrs. Jarvis Farley, as well as two of Jarvis and Betty's daughters, Penelope and Pat. Mrs. Farley has consented to share with us a few of her reflections on this occasion.

Mrs. Farley: I was deeply moved when I was told about the Jarvis Farley Service Award. Jarvis was very proud of being an actuary. I reminisce back to the time when I had my first date with Jarvis, and when it came time to end the evening he turned to me and he said, "I've really enjoyed this evening."

And I looked a little expectant, and he said, "As a matter of fact, I'm sorry I won't be able to see you for quite a while." And I waited. And he said, "I'm going to have to study." Well! I was stunned.

Here was this graduate of Harvard University, *magna cum laude*, Phi Beta Kappa, telling me he could not have another date with me for a long time because he had to study. I said good night, and went in the door.

Well, needless to say, that was—how many?—fifty-three years ago. And he did study, and he kept on studying. And he served the actuarial profession.

I was so interested to hear this last report [by Jim Murphy], because one of the things that Jarvis did do while he was active was to be very interested in maintaining the high actuarial standards of practice. I have been going through his files, and I see these references.

Jarvis was a keeper too, and there are lots and lots of files that I am going to go through. But the other thing was his service, and he blazed a trail when he started trying to establish ABFA, actuarial based financial accounting, and that took quite a lot of doing.

I just want to thank you very much for honoring him in this way. I was very moved when I heard about it, and, I was

just going to say, I wish he knew. But how do we know? Maybe he does. Thank you.

President Garber: This award symbolized by a silver bowl on display in the Academy office. We will have the name of the person who receives the award each year inscribed on the bowl. And then the individual will receive a replica of the bowl.

[To Mrs. Farley] We wanted to give you a bowl that will be similar to the one that will be received by all the recipients of the Jarvis Farley Service Award in future years.

Mrs. Farley: Oh, thank you so much. That's wonderful.

President Garber: As my first official act as president of the Academy, I declare the business meeting adjourned. But don't go away, because we are expecting Senator Metzenbaum any minute.

Something I hope you all picked up when you registered, is the *Issues Digest*, published by the Academy. It gives a fairly good background and picture of the key issues that we have been and will be addressing in our government information program this year.

FASB'S DICTUMS ON DISCOUNTING*(continued from page 15)*

Allan Kaufman discussed the Academy's response to FASB on the discussion memorandum. Kaufman listed three requirements of all accounting systems:

1. The system should not allow artificial gains to be realizable.
2. Insurance company decision making should not be distorted.
3. Adequate reserves should be encouraged, not discouraged.

These requirements must be reflected in any modification made to the current accounting system. The Academy statement made three key points:

1. If a present-value method of accounting is adopted, a risk adjustment is necessary.

2. Actuarial science will determine how to calculate risk adjustments, since accepted methods don't exist today.

3. The interest rate used to discount reserves must depend on asset valuations used in the balance sheet. Bonds must be valued at market value, not amortized value.

Finally, Kaufman presented the basic accounting rules that state: If cash flows are reliable, discount them. If cash flows are not reliable, don't discount them.

An alternative view of the accounting rule may be appropriate for property/casualty reserves. Although the reserves are not necessarily reliable, discounting still may be appropriate with an adjustment to reflect risk factors.

Kadison is manager for Price Waterhouse in Hartford.