The Actuarial Update

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Junk Bonds and Life Insurer Solvency

by Jeanne Casey

At a June 18 hearing, the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce continued its inquiry into the adequacy of solvency regulation for insurance companies doing business in the United States. Rep. John Dingell (D-MI) noted in his opening remarks that the subcommittee's previous inquiries and its recent report, "Failed Promises," dealt primarily with the solvency problems of property/casualty companies. "Many people have said that we should also look at potential solvency problems of the 2,400 life insurance companies," Dingell said.

Executive Life Insurance Company of California, a subsidiary of First Executive Corporation, came under particular scrutiny at the hearing. At issue was whether Executive Life is financially sound or not, and whether regulators should stipulate generally how much of a company's assets can be invested in high-yield, or "junk" bonds. Insurance Forum, Inc. reported that, on December 31, 1988, Executive Life had 50% of its assets in junk bonds, and a ratio of junk bonds to net worth of 2,845%.

California State Assemblyman Patrick Johnston, and chairman of the Assembly's Finance and Insurance Committee, testified that his committee became concerned with the effect of junk bonds on the solvency of life insurers in California, in December 1989, when Executive Life, one of California's largest life insurance companies, "had attempted to improve its financial picture by transferring over $700 million in junk bonds to six wholly-owned subsidiaries and converting such junk into what are called 'collateralized bond obligations.'"

"Junk bonds," also called high-yield securities or speculative grade securities, include securities that are rated BB+ or lower by Standard and Poors, or Ba1 or lower by Moody's. A consultant to the Finance and Insurance Committee, Ross L. Sargent, has stated that "junk bonds present three major concerns to regulators: credit risk, liquidity risk, and reinvestment risk. The overall concern is that such junk bonds will dilute the quality of [an] insurer's portfolio and will not be available for the policyholders in the event of a recession."

Fred Carr, chairman and chief executive officer of First Executive Corporation, testified that "Executive Life is an example of a life insurance company with a substantial investment in high-yield bonds that has managed to remain sound and solvent despite the recent massive turmoil in the high-yield bond market, despite extreme adverse publicity, and despite a resultant dramatic increase in policy surrenders and withdrawals." He said that Executive Life is an example of "how to manage and structure an insurance company to survive a crisis while still delivering excellent value to policyholders."

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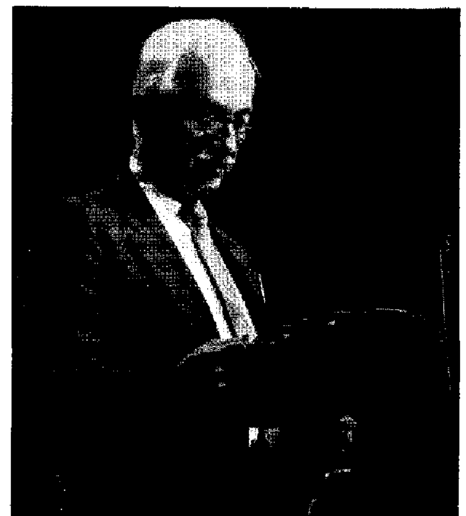

Academy President Harold J. Brownlee presents a gift to the Canadian Institute of Actuaries, "in recognition of exceptional leadership and distinguished service to the profession" at the Institute's twenty-fifth anniversary meeting. (Brownlee spoke in French.)

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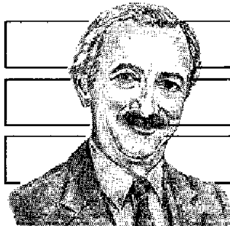


From the President

Harold J. Brownlee

Squeezing the Sour, Making it Sweet

Since the future is unknowable, planning for it is risky, but plan we must. Planning helps us to position ourselves, so that it will be relatively easy for us to move in the direction of those good things that come along. Conversely, we want to be able to avoid the bad things out there. But not only do we want to avoid bad things, we want to be able to take a bad or indifferent thing and turn it into something good. If given a lemon, be able to make lemonade!

That our profession is concerned about the future is evidenced by the creation of task forces such as the Joint Task Force on Strenghtening the Actuarial Profession, the Task Force on the Actuary of the Future, the Joint Task Force on Professionalism, and the Joint Working Agreement Task Force, just underway. The activity of these task forces is based on the belief that the decade of the 90s and those beyond will present work environments for actuaries, quite different from the ones we've known.

As the Task Force on Strengthening the Profession looked into the future, one "lemon" it identified was the profession's lack of effective public interface in the United States as a result of there being numerous actuarial organizations. Three varieties of lemonade (three good outcomes) have resulted from the task force addressing this problem. One is the inclusion of presidents and presidents-elect of the other organizations on the Academy's Board of Directors. This initiative, to be completed next year, will ensure that the other organizations have input into the Academy's public-interface planning.

A second variety of lemonade to result is the Joint Task Force on Professionalism itself. Its mission is to reduce the overlap and inefficiency of the complaint and discipline processes of the various organizations. A third batch of lemonade will result when the Joint Working Agreement Task Force identifies other areas where the organizations are needlessly duplicating each others' efforts, and suggests ways to streamline these efforts.

A recurring theme among the task forces is that we may not need six actuarial organizations within the United States and Canada, with overlapping memberships, in order to meet the needs of members and their publics. Reducing the number of organizations from six to some smaller number is a topic that we will continue to think about a lot. However, at least for now, the prospect seems unachievable. Nevertheless, if circumstances should suddenly make it possible to reduce the number of actuarial organizations to five, we want to be ready. To apply my statement about planning: We want to be in a position to choose the good thing when it comes along. And the corollary: We must try to avoid the sort of disagreement within the profession that would increase the number of organizations to seven.

Another idea that keeps surfacing is that each Academy member spends his or her working hours in one of four specialty areas—casualty, health, life, or pensions. This perception leads to such interesting proposals as splitting the Academy membership into four groups, giving each group some measure of autonomy. Some argue that, since we live in an age of increasing specialization, it should be *easy* to draw the lines between these areas of practice. Yet, the Academy has found that it's not so easy—when it has tried, the boundaries just get fuzzier and fuzzier.

Although some actuaries spend an entire career in one of the four traditional specialty areas (casualty, life, health, or pensions) many others change practice areas one or more times during their careers. Also, there are many actuaries who routinely work in several areas, and others who work as actuaries, but in none of the four areas.

At professional meetings, I have heard colleagues from the Canadian Institute of Actuaries express concern about the emphasis that U.S. actuaries seem to give their specialties. If asked what we do, we say we're a life-actuary, a health-actuary, a pension-actuary, or a casualty-actuary. This concept of "hyphenated actuaries" needs to be watched closely, because our preoccupation with specialities could lead to that unwanted seventh organization.

The Academy membership requirement of three years of responsible actuarial experience in "life and health insurance involving individual policies,

group insurance, social insurance, pensions, or property and liability insurance," raises a related issue. Just because the specialities listed by the Academy were *the* "recognized" areas of practice in the past, aren't there now *other* practice areas that could be considered for the Academy's experience requirement? An actuary whose total experience is in continuing care retirement communities, for example, is not eligible to join the Academy, even though the Actuarial Standards Board has issued a practice standard that applies to Academy members practicing in that area. Another area of work that will not qualify an actuary for Academy membership is investments, a growing field in which actuaries are becoming increasingly involved.

If there is still the need for an experience requirement, we need to understand why. Are we trying to protect the public with this requirement, or is it a device to exclude some actuaries who are otherwise qualified? If the former, we should be able to explain how the public is protected; if the latter, why would we want to keep any qualified actuary from becoming an Academy member?

Consider that an Associate of the Casualty Actuarial Society with no experience is permitted to sign a casualty loss reserve opinion by the National Association of Insurance Commissioners (NAIC), but that same actuary is not eligible to join the Academy. Don't we want any actuary signing an NAIC opinion blank to be subject to the Academy's standards of conduct and practice? With these and the other issues facing our profession, it's no wonder that we are putting so much time and effort into positioning ourselves for the future.

Our profession and all of its organizations are moving through rapidly changing times. Even as we try to adapt to present changes, let us stay alert for those that are yet to come. There are a lot of lemons out there, so let's be ready to make lemonade! Δ

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

Another Toot on the OASDI Whistle

In his letter to the editor in the June issue, Ken Steiner suggests that the close actuarial balance "warning whistle" for Old Age, Survivors and Disability Insurance (OASDI) is sounding an inappropriate alarm because the problem "might not materialize for sixty years." The facts are that, under intermediate assumptions, OASDI tax income is projected to fall short of expenditures beginning in 2018 (in 2011 under pessimistic assumptions). The program's accumulated assets can be used to meet the shortfall for another twenty years, although it should be remembered that these assets represent little more than a claim to future government revenue.

Many analysts have proposed further increases in the normal retirement age as a responsible way to provide OASDI benefits at an affordable cost. If such a change were to be considered for the "baby boom" generation, it should not be done without advance warning measured in decades rather than months or years. Considering that the baby boomers will begin to reach retirement age in only twenty years, it hardly seems too soon to be considering how best to eliminate OASDI's long-range financing imbalance.

Suppose, however, that the warning whistle continues to be ignored, and no action is taken until 2020 or 2030. At that time, it will be much more obvious that the $9 trillion owed to OASDI by the U.S. Treasury can only be repaid through an increase in income taxes or other federal taxes (or more borrowing). The baby boom generation, having agreed to pay higher tax rates during their working lives "to help provide in advance for their Social Security benefits" will now be asked to pay higher income tax rates "to pay back the money owed to Social Security."

It could make the current savings and loan scandal look pale by comparison . . . .

Richard S. Foster
Baltimore, Maryland

Note: Foster's views do not necessarily reflect those of the Social Security Administration, where he is deputy chief actuary.

(*continued on page 6*)

"The bad news is we've managed to get the public *and* private sectors hopping mad at us. The good news is there aren't any other sectors to worry about!"

JUNK BONDS AND LIFE INSURER SOLVENCY
(continued from page 1)

Carr argued that "a life insurance company which has a substantial investment in high-yield bonds can be managed to safeguard solvency—even if individual high-yield bonds are a relatively 'risky' investment and even if that risk comes home to roost in the form of a high-yield bond market crisis." According to Carr, "a properly structured high-yield bond portfolio is not 'riskier' than one featuring real estate and mortgages." In 1989, according to Alliance for Capital Access data, the default rate on high-yield bonds was 3.82 percent. " Not good," said Carr, "but hardly a disaster. By comparison, while 1989 figures are not yet available, the default rate in 1988 for all commercial loans by banks was 5.25 percent; the 1988 default rate for loans secured by real estate was 5.19 percent."

"The theory of high-yield bonds is that the higher interest rate compensates—arguably more than compensates—for the additional default risk. This is a theory that is amply supported by the evidence, even if it is not universally agreed to. While holding one or a few high-yield bonds could be risky, if you hold a diversified portfolio of the bonds of many issuers, the defaults and higher yields should average out to produce a total return—net of defaults—no less than a portfolio of highly rated bonds," Carr said.

Sargent reported that Executive Life "wrote down" about $1.4 billion of its assets as of December 1989, because companies in which Executive Life held junk bonds had defaulted. Sargent has suggested that "if Executive Life was required to mark its junk bond portfolio 'to market' as opposed to being allowed to carry the junk bonds on its books at amortized value, the company would in fact be insolvent."

"With the decline in the market price of high-yield bonds, the current market value of our assets is less than our cost by about $1.57 billion," testified Carr. He acknowledged that this fact had led some people to assert (as Sargent has) that Executive Life would now be insolvent if its assets were "marked to market."

"The market value of a portfolio is a useful piece of financial information for some purposes," said Carr. However, it "is not an appropriate way to determine an insurer's solvency," he added. He noted that the actuarial study of Executive Life's solvency required by the California Insurance Department when the company had announced it would have to take write-downs for last year, "found us solvent—solvent even if things got much worse in the future."

Note: The actuarial study Carr referred to was one of two studies prepared by Milliman & Robertson. According to Executive Life's summary report for clients, the first study examined the impact of various actuarial assumptions on book value. The second study focused on the adequacy of Executive Life's reserves in several other scenarios—"in order to determine the level of defaults at which [the company] would break even and still maintain a strong balance sheet."
Δ

AFIR Meeting Announcement and Request for Papers

AFIR, the financial section of the International Actuarial Association, exists to address those financial and investment issues of interest to actuaries, and to act as a link between actuaries and other financial experts around the world who are interested in such issues.

Plan to attend the next AFIR meeting in Brighton, England, April 17 to 20, 1991. The program will cover a spectrum of financial topics, and you are encouraged to submit a paper. Please review the AFIR insert enclosed with this mailing of *The Update* for details.

IRS Assistant Commissioner Brauer Will Personally Review Audits

Judging from recent calls received by Academy staff, many small pension plan actuaries are not yet aware of Internal Revenue Service (IRS) Assistant Commissioner Brauer's offer to review cases personally, where the field auditors have not adhered to the principles of facts and circumstances. Brauer made this offer in April and, as of July 1, had only received six cases for review.

According to IRS staff, Brauer revised the findings of the field auditors in three cases and agreed with the IRS auditors in three cases. One of the cases led to IRS's discovery of an auditor who had been overzealous in disallowing pension contributions.

To help those of you who may want to take Assistant Commissioner Brauer up on his offer, we're providing some guidance on how to bring your case to his attention. (This information was compiled by the American Society of Pension Actuaries.)

- The case should be referred to Brauer after receipt of the "10-day" letter. You should also proceed with any action you would normally take to respond to the local IRS office concerning the "10-day" letter.
- It is not necessary that the complete case file be forwarded to Brauer. Information forwarded should be sufficient to (1) identify the case, (2) identify the IRS office and agent that conducted the examination, and (3) substantiate the agent's failure to adhere to the facts and circumstances approach. Note: this is *not* an opportunity to present new facts and circumstances.
- Consider that this review does not impact on the regular IRS administrative process. Consequently, while the review is being made, the taxpayer should take whatever action is necessary to preserve appeal or litigation rights.

Send your request for audit review to: Mr. Robert Brauer, Assistant Commissioner, EP:EO, Internal Revenue Service, 1111 Constitution Avenue, N.W., Room 3408, Washington, DC 20224.

IRS Visting Actuary Karen Krist met with the Academy's Pension Committee, June 13. Representatives of the American Society of Pension Actuaries, the Society of Actuaries, and the Conference of Actuaries in Public Practice (CAPP) attended the committee meeting to hear Krist's comments on the small plan audit program and to plan the committee's public statement.

CAPP leaders Wynn Kent, Larry Mitchell, and Jeffrey Furnish met with Brauer on June 22nd. Δ

Fibiger Reports on Discipline Committee Actions

by Gary D. Simms

Fourteen pending disciplinary actions and ten recently closed matters were reviewed by the Academy's Board of Directors at its June 4 meeting in Baltimore, Maryland. Committee on Discipline Chairperson John Fibiger described the current caseload and outlined the actions taken on behalf of the committee since its last report to the board in December, 1989.

Four Cases in Litigation

Of the fourteen cases now on the committee's docket, three involve allegations of actuarial error involved in the insolvencies of insurance companies. Another involves an allegation of fraud by an Academy member working for a real-estate investment company. These cases are all presently in courts, and the committee is monitoring the litigation in each instance.

Complaints Under Investigation

Several pending disciplinary cases reveal a pattern of misfeasance by pension practitioners, in most cases as a result of a failure to provide clients with timely financial reports and 5500 forms. In one such case, two different clients registered complaints with the Academy seeking assistance in having the members provide the promised-for work product. In a second case, three different clients registered similar complaints. In a third case, three different complainants, including an accounting firm, asked both the Academy and the Joint Board for the Enrollment of Actuaries to assist in efforts to gain plan records and reports that were in the possession of members. Investigations are now underway in each case.

In another pending case, allegations of malpractice and fraud have been raised by the former employer of a pension actuary. The employer claims to have learned of improper practice by the former employee, including the submission of false reports to the Internal Revenue Service. In another case, a member is alleged to have improperly back-dated certain pension filings to increase potential tax deductions for a client. The committee is continuing to investigate these matters.

Whether a member properly complied with applicable standards of practice concerning HMO financial reporting is an issue now being evaluated by the committee, with assistance from the Actuarial Standards Board's Health Operating Committee.

Cases Involving Qualifications

The disciplinary committee is also reviewing a series of cases involving the qualifications of members to undertake particular assignments. In one pending case, the qualifications of a member to sign a loss reserve opinion was questioned by a state regulator. The member was allegedly not qualified to render the opinion, although the validity of the opinion expressed has not been challenged.

The issue of whether or not an actuary had complied with the Academy's qualification standards for signing loss reserve opinions was raised in five separate cases reviewed by the committee. Academy qualifications standards do not *require* membership in the Casualty Actuarial Society for Academy members who sign loss reserve opinions, but do require the member to have comprehensive knowledge of the assignment's subject matter, having had responsibility for the function in the past and having carried it out successfully. The Academy's *Guides to Professional Conduct and Interpretative Opinions* call for members to judge themselves, as to whether they have the knowledge, experience, and ability to undertake an assignment, and to defend their actions to their peers, if their qualifications are questioned.

In each of the five cases evaluated and closed by the committee, the individuals engaged in the activity demonstrated qualifications for the type of assignment in which they were engaged. It is important to note that in most of these cases, the loss reserve techniques required were elementary, or the liabilities involved were minor. In one case, the subject of the opinion dealt with health company operations, for which the actuary was fully qualified. It was noted that these committee determinations were not "blanket approval" for the individuals to engage in all kinds of loss reserving; rather, the particular assignments in which the actuaries had engaged were within the scope of their capabilities. In several situations, the committee recommended to the individuals involved that they formally seek recognition from the applicable state insurance departments for future opportunities to prepare loss reserve opinions.

Cases Closed

In another case involving practice qualifications, the focus was on health filings, it being alleged that a member had provided improper advice to an insured health trust that subsequently became insolvent. A review of the matter indicated that the opinion was reasonable at the time it had been rendered, and the case was closed.

Another closed case involved an alleged conflict of interest by a member in the preparation of testimony before a state rating board. Investigation demonstrated no conflict of interest, and underscored that the testimony delivered had been reasonable.

In a closed pension-related case, a complaint had been filed by a former employee of an Academy member on the grounds that the member did not properly administer the pension plan in which the complainant had been a participant. Following the withdrawal of the complaint by the former employee, the matter was closed. In another closed case, a complaint had been filed claiming that the member violated ethical requirements, by urging a client to change policies from the client's current insurance carrier to another company, for which the member performed actuarial work. Investigation disclosed that no violation of ethical standards had taken place, and that the matter was purely a business dispute between the member and his client.

Additional reports on disciplinary activity will be provided to readers of *The Actuarial Update* twice yearly. Individuals who would like to consult with the Committee on Discipline are invited to telephone the Academy's Washington office, or to write Chairperson John Fibiger, at his yearbook address. Δ

LETTERS TO THE EDITOR
(continued from page 3)

Tipping the Pay Scales

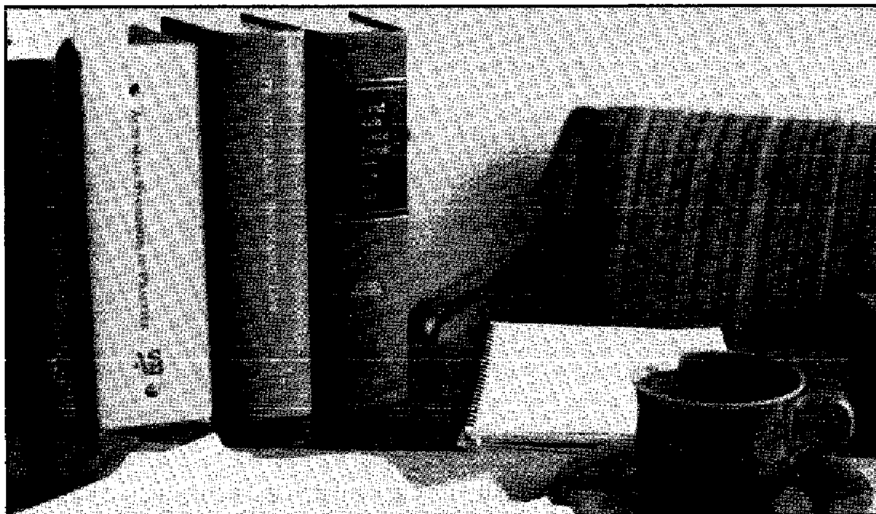
Enough already! Toni Hustead may believe what she says about actuarial salaries in the federal government very sincerely (June *Update*), but what she says does not stand up to close scrutiny. For example, her "research" indicated that federal actuarial pay was 48% behind private-sector pay "at the higher levels." Who decides which actuaries are at what levels? Toni herself was named chief actuary of the Defense Department while a young ASA. Should her pay be compared to that of the typical twenty-year FSA who is chief actuary of a large insurance company? Even that comparison may be difficult, considering all of the elements that enter into the compensation of private-sector actuaries.

In any event, actuaries—like all people—do not choose jobs on the basis of salary alone. Other considerations include employee benefits, working conditions, and job security. In those respects—particularly the last—federal actuaries are generally ahead of their private-sector counterparts.

The studies comparing actuarial salaries in the government to those in the private sector are inescapably meaningless. At best, they compare apples and oranges. At worst, they are searches for data to support a predetermined conclusion—that federal actuarial salaries need to be raised. The Academy and the actuarial profession are better off not getting involved

Bruce D. Schobel
New York, New York

The editor responds: The fact that Toni Hustead was named chief actuary at the Defense Department "while a young ASA," probably proves her point. It is likely that the federal pay scales could not attract an experienced FSA to the position. Considering the record of her achievements, the Defense Department made a fortunate choice in hiring Hustead. As to whether the Academy should be involved in the issue of increasing federal pay scales for actuaries—the Academy is vitally interested in any effort that may attract competent actuaries to government service.



Actuarial Standards Handbook Distributed to Members

By now most Academy members should have received by mail their standards handbooks. The handbook contains all actuarial standards of practice and actuarial compliance guidelines promulgated by the Actuarial Standards Board (ASB) and previous standards-setting bodies, the Interim Actuarial Standards Board (IASB) and the American Academy of Actuaries' Board of Directors. Also contained in the handbook are a preface describing the structural framework within which standards are developed and under which they are intended to operate; the procedures manual of the ASB; and introductory notes.

The appearence of some standards will be slightly different from earlier published versions because of modifications in the format, as well as some minor editorial changes. The versions contained in the handbook supersede all earlier versions.

As new standards are promulgated, they will be distributed to the membership in hole-punched form for inclusion in the handbook. Exposure drafts may also be added to the handbook.

The *Financial Reporting Recommendations and Interpretations* and the *Recommendations and Interpretations for Dividend Determination*, previously published in the Academy yearbook, have been reprinted in booklet form and are included in the handbook. These older standards are in the process of being revised and updated. This effort will continue for about two years. As the revised standards are reviewed and adopted by the ASB, they will be distributed to Academy members.

Please notify the Academy office, if any items are missing from your handbook; also note that a correction reply card for Standard No. 6 is enclosed with this copy of *The Update*.

An Insight to be Proud of

Mike Fusco's editorial "From the Guest President" (June 1990 *Update*), is proof again that the most powerful ideas are often the most simply expressed. His elemental idea that one is an actuary-casualty, or an actuary-life, etc.—that is, a specialist within the profession—captures the whole concept in one grand stroke. Make no mistake about it, I consider myself an actuary-CASUALTY and have been fiercely proud of it since 1954. However, there have been times when my fellow actuaries and I have forgotten that the word "actuary" should come first. Let's hope that everyone will keep this thoughtful reminder, which was so easily expressed, in the forefront of our discussions, during the next decade at least.

LeRoy J. Simon
Morristown, New Jersey

Legal Lines

A Lesson in Conflict of Interest

by Gary D. Simms

A highly unusual fact pattern in a recent New York case underscores how important it is for actuaries to consider potential conflicts of interest, before giving expert witness testimony. The case of *Krumme v. West Point-Pepperell*, S.D.N.Y., (No. 89 Civ. 2016, April 19) involved a dispute over deferred compensation, following the aquisition of Cluett, Peabody & Co. by West Point-Pepperell (WPP). According to the merger agreement, the actuarial assumptions used in the Cluett pension plan were to be used in calculating lump-sum benefits to Cluett employees who were laid off as a result of the merger.

The plaintiff, Krumme, a former Cluett employee, filed a motion for summary judgment with the court, in effect asking the court to make a decision without a trial, since there were no facts being disputed. Included with Krumme's motion was the affidavit of a partner from the large actuarial firm that had done consulting work for the Cluett plan prior to the merger.

After the affidavit and motion were filed, an employee with William Farley Inc. (whose company had subsequently assumed control of WPP) complained to the actuarial firm that its filing the affidavit involved the firm in a conflict of interest, because the firm currently manages one of Farley's employee savings plans. The actuary and his firm then asked the court's permission to withdraw the affidavit, on the grounds that a conflict of interest existed.

Court Retains Affidavit

The court's opinion noted that expert witness testimony cannot be compelled under applicable New York law. But, the court said, this was not a case of compulsion as alleged by the actuary; rather, the actuary had completed his work willingly and submitted the statement of his own volition. (The court refused to rule on whether the actuary could be called to testify, as an expert, should a trial eventually take place.)

The actuary and his firm argued that the conflict of interest, in violation of the Academy's *Guides to Professional Conduct* 2(b) and 2(d), provided a basis for withdrawal of the affidavit. However, the court noted that the "public has a right to everyman's evidence," except for those persons protected by a constitutional, common-law, or statutory privilege.

Noting that New York case law is silent on the existence of a so-called actuary-client privilege, the court examined New York law as it applies to accountants and found that, in that state (as in most others), there is no statutory or common-law accountant-client privilege. Hence, the claim of conflict of interest is insufficient to provide a basis for the withdrawal of the affidavit.

Finally, the court reviewed the applicable federal rules of evidence, finding that their essential purpose was to bring before the court all relevant evidence and to avoid unjustifiable expense and delay. The court found that allowing the actuary to remove his fifteen-page, detailed affidavit would require the plaintiff to secure a substitute, which would only serve to lengthen the proceedings and add unnecessary expense. Thus, the motion to withdraw the affidavit was denied.

This case has some important lessons for actuaries called upon to give expert witness testimony. First, any possibility of a potential conflict of interest has to be reviewed. Before providing testimony or service, actuaries, especially those employed by large consulting firms, should check to see whether the company is representing any other party that would create a conflict of interest, if the actuary were to provide the requested testimony. Also, actuaries should be cognizant that the courts do not recognize actuary-client privilege; an actuary's work papers and so-called "confidential" materials can be requested by the courts in the course of litigation. Finally, it needs to be noted that, while the Academy's rules of conduct are important to members of the profession, the rules will not necessarily provide legal recourse. Nor can we look to the courts to enforce the profession's rules of conduct.

Simms is general counsel for the Academy.

McCarran-Ferguson Repeal Clears Judiciary Committee

On June 20, the House Judiciary Committee, in a 19 to 17 vote, approved a bill to repeal the broad antitrust exemption granted the insurance industry under the McCarran-Ferguson Act. The Insurance Competitive Pricing Act of 1990, bill H.R. 1663, provides that the Sherman Act, the Clayton Act, and Section 5 of the Federal Trade Commission (FTC) Act, relating to monopolization and unlawful restraints of trade, shall apply to the business of insurance to the extent that it: (1) is not regulated by state law or (2) involves price fixing, allocation of market territories, tying arrangements and monopolization. Three Judiciary Committee Democrats voted against the bill: Reps. Glickman (KA), Morrison (CT) and Feighan (OH). All of the committee's Republicans opposed the bill. During the committee mark-up, Rep. Tom Campbell (R-CA) asserted that the proposed bill would be more restrictive than outright repeal of the McCarran-Ferguson Act. Congressman Campbell is a former antitrust law professor and has served as chief of the FTC's Bureau of Competition.

H.R. 1663 now goes to the Rules Committee. That committee will determine when the bill will go to the House floor, and the rules for the floor debate. Consumer advocates, who hope to make H.R. 1663 a grass-roots issue, are expected to lobby strongly to bring the bill to a House vote before the November elections.

Summary Report from the Treasurer

Highlights of the Academy's audited financial statements for 1989 are included in this issue of *The Actuarial Update*.

Note that the auditor's opinion does not include any qualifying reservations. During 1989, expenses exceeded revenue by $74,002, thus lowering the fund balance to $671,702.

Compared to 1988, the major increases in expenses were for the Actuarial Standards Board (ASB) and *Contingencies*, as well as for the hiring of additional staff for governmental relations. The Academy continued to operate at a deficit, although the amount of that deficit declined somewhat.

For 1990, the budget projects that revenue will exceed expenses, because of increased dues and interest income. Increased expenses will primarily relate to full implementation of the government relations program and to preparation, publication, and distribution of a standards notebook by the ASB.

Thomas D. Levy
Treasurer

Balance Sheet December 31, 1989

Assets	General Fund
Current assets:	
Cash	$ 101,267
Certificates of deposit	199,000
Money market funds	1,202,547
Accounts receivable	112,151
Accrued interest receivable	7,234
Prepaid expenses	60,343
Deferred sublease expense	963
Total current assets	$1,683,505
Certificates of deposit -- long-term	395,000
Deferred sublease expenses -- long term	352
Furniture, equipment & leasehold improvement, net	114,195
	$2,193,052
Liabilities and Fund Balances	
Current liabilities:	
Accounts payable	$ 262,527
Deferred membership dues revenue	1,187,535
Deferred revenue--other	45,429
Accrued expenses	13,524
Deferred rent credit	2,145
Total current liabilities	$1,511,160
Deferred rent credit--long-term	10,190
Fund balance	671,702
	$2,193,052

AAA 1989 Functional Allocation

Dues Incomes	$1,680,165
Dues rate	200
Membership base	8,401

Item	Per Member*
Government Information	$ 35
Public Relations	29
Member Communications	30
Organizational Services	7
Interorganizational Liaison	10
Executive/Administrative	41
Actuarial Standards Board	41
Contingencies	31
Change in reserves	(24)
Dues rate	$200

*Net of non-dues income

AMERICAN ACADEMY OF ACTUARIES

Statement of Revenue and Expenses
Year ended December 31, 1989

	General Fund
Revenue:	
Membership dues	$1,680,165
Membership application fees	26,100
Interest	130,878
Administrative services	123,157
Academy Alert subscriptions	27,975
EA meeting distribution	95,603
CLRS distribution	44,350
Advertising income	142,170
Other	19,013
	2,289,411
Expenses	2,363,413
Excess (deficiency) of revenue over expenses	$ (74,002)

Statement of Expenses
Year ended December 31, 1989

	Academy Operations	Actuarial Standards Board	Total
Staff salaries	$ 685,166	$ 88,994	$ 774,160
Employee insurance	53,407	6,940	60,347
Payroll taxes	44,618	5,798	50,416
Retirement plan	98,059	12,742	110,801
Temporaries and personnel fees	12,882	-	12,882
Rent	135,687	18,080	153,767
Telephone	9,144	1,188	10,332
Postage and freight	71,357	28,080	99,437
Travel and related expenses	86,233	40,462	126,695
Committee meetings	38,444	13,714	52,158
President & president-elect travel	40,363	-	40,363
General office supplies & rentals	60,555	7,808	68,363
Printing	161,466	72,383	233,849
Service agreement (SOA)	56,987	-	56,987
Audit & accounting	15,578	2,024	17,602
Insurance	11,731	1,524	13,255
Depreciation & amortization	23,538	3,279	26,817
Subscriptions & periodicals	8,208	1,067	9,275
Public relations	74,644	14,548	89,192
Academy Alert	11,566	-	11,566
Magazine research & expenses	255,029	-	255,029
Professional services	6,492	-	6,492
Search and relocation expenses	30,000	-	30,000
Standards handbooks	-0-	22,269	22,269
Other	30,239	1,120	31,359
	$2,021,393	$342,020	$2,363,413

Checklist of Academy Statements June 1990

TO: National Association of Insurance Commissioners (NAIC) Life and Health Actuarial Technical Task Force, June 1, 1990. RE: Proposed Small Group Health Rate Reforms. BACKGROUND: This memorandum from the Academy's Subcommittee on Liaison with the NAIC Accident and Health (B) Committee is in response to the NAIC task force's request to review two industry proposals on small-group health rating. Specifically, the NAIC task force asked the Academy's subcommittee to consider whether there should be separate guidelines for small groups and whether the industry proposals were compatible with the individual rate filing guidelines. The subcommittee noted several areas of overlap and incompatibility between the two small group proposals and the individual rate filing guidelines. Nonetheless, the subcommittee concluded that there should be separate guidelines for small groups because small-group rating practices differ from individual rating practices.

TO: National Association of Insurance Commissioners (NAIC) Life and Health Actuarial Technical Task Force, June 1, 1990. RE: Valuation of Long-Term Care Liabilities. BACKGROUND: This memorandum from the Academy's Subcommittee on Liaison with NAIC Accident and Health (B) Committee is in response to the NAIC task force's request to comment on two questions concerning the valuation of long-term care liabilities. The first question was whether the first-year preliminary term (1YPT) method is an appropriate method for establishing initial reserves for individual LTC insurance. The subcommittee concluded that the 1YPT method was generally appropriate and recommended its adoption. The subcommittee's memorandum includes several sets of comparisons of the excess of the full net level benefit premium over the first year claim cost and the first year acquisition cost. The second question was: In the absence of a valuation table, what can be used as a reserve basis? The subcommittee noted that the model minimum A & H reserve standard addresses this situation in Section 45, Paragraph B and recommended that, in line with the model standard, the pricing basis with appropriate margins generally be used as the basis for valuation.

TO: Diana Scott, Project Manager, Financial Accounting Standards Board (FASB), June 22, 1990. RE: Accounting for Retirement Benefits Other Than Pensions — Actuarial Practice and Per Capita Claims Cost. BACKGROUND: This letter to FASB is from the Retiree Benefits Subcommittee of the Academy's Committee on Health and Welfare Plans. The letter discusses potential difficulties in using per capita claims cost as a basis for valuing employers' liabilities for retiree health insurance. Data on gross charges for retiree health benefits (i.e., charges prior to Medicare payments, deductibles and other cost-sharing requirements) are generally not available. The subcommittee is concerned that FASB may require the use of gross charges, or incurred claims "grossed up" to estimate gross charges. Both options present problems. Gross charges data frequently are not available and would often be expensive to obtain and, for small groups of retirees, would not be credible in any case. If "grossing up" were required, it seems likely that the estimates would not be improved over those obtained through current actuarial practice and methodology.

TO: Federal Policy Makers and Other Interested Parties, June 26, 1990. RE: Long-Term Care (LTC), Issues and Costs. BACKGROUND: This background statement by the Committee on Health examines current expenditures (including those from private income and savings) on LTC and the expected growth in expenditures between now and the year 2000. Currently, total private and public expenditures for LTC are $50 billion, 50% of which are paid from private savings. By the year 2000, LTC expenditures will have reached approximately $225 billion. This estimate takes into account population aging, plus inflation and improvements in medical technology, and assumes no new government programs. This brief white-paper also points out the major objectives that any national LTC program must meet, if it is to be cost-effective. Among these objectives are a precise statement of the circumstances under which benefits will be paid and appropriate safeguards to avoid overutilization.

On the Road with Media-Savvy Hal

by Ken Krehbiel

Braving 112° heat and filthy brown Los Angeles air on the first day and reveling in the balmy, blustery Bay weather of San Francisco on the second day, actuary Hal Barney embarked on yet another Academy-sponsored media tour, on June 26 and 27. The topic was continuing care retirement communities (CCRCs); the objective was to inform consumers that they should ask to review a community's actuarial report before deciding on a CCRC.

For those unfamiliar with public-relations speak, a *media tour* is a collection of print and broadcast media bookings in two or three markets, over the course of a couple of days. This reporter bore the responsibility of arranging engagements for Hal, who is a member of the Academy's Committee on Continuing Care Retirement Communities and a veteran of several media tours. Following Academy Director of Public Relations Erich Parker's media tour credo, "Just get him in the chair" (here paraphrased), your reporter managed to get Hal's appropriate anatomy into every scheduled chair on time.

It's been said that public relations is a high-volume, low-success endeavor. Countless pitch letters and telephone calls to three major metropolitan areas proved it. Thanks to persuasion and persistence, however, the actuarial message on CCRCs was heard in three markets: Los Angeles, Palm Springs, and San Francisco.

Night One, Day One

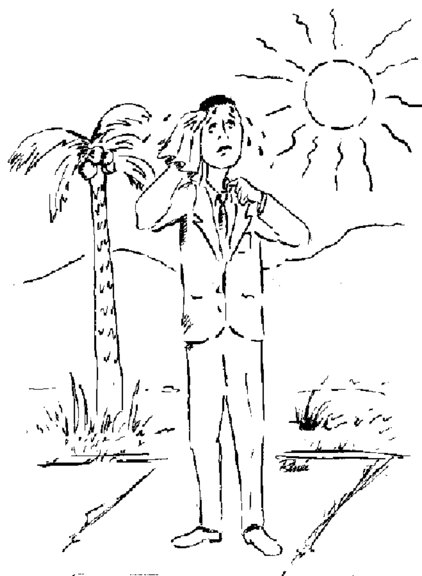
After a barrage of calls, unanswered messages, an ignored overnight Fed Ex, and travel plans altered contingent upon an interview confirmation that never came, a message is awaiting upon arrival at the Hyatt Wilshire in Los Angeles. It confirms a morning interview just up the street at oldies station KRLA. Only one thing is missing—the time of the interview. Considering the interviewer's workday is from 5:00 a.m. until 10:30 a.m. and her record of unreliability returning all kinds of messages and priority postal appeals, it may be best to arrive early.

Later that night Hal's phone call upon his arrival interrupts my shallow

sleep. He is brought up to date and seems unruffled and understanding of the uncertainty. We agree to meet for breakfast early.

Morning dawns warm and smoggy. The trek down the street takes only a few minutes. Miraculously, not only is the building open, a buzzer sounds granting entry into a nearly empty, funky looking radio station—this at 7:00 a.m. Ms. Interviewer is shocked and delighted to see us—two hours early. She exclaims, "I've never had anyone this early before!" and tells us the interview is for nine o'clock—when the station opens. Plenty of time for breakfast.

The walk back to the hotel is warmer, the asphalt is definitely softening and heating up. Hal downs an omelette. Fortified and sated, he is ready for radio.



Ms. Harris (aforementioned interviewer) is as ebullient in the studio and on mike as she is in person. The only slip is when Hal smoothly slides the call letters into one of his responses. Unfortunately the call letters are those of the FM side; the interview is on the AM sister station. The interviewer laughingly corrects him, goes with the flow, and facetiously says, "We'll just edit that out." The twenty-minute show flies by. Hal pronounces her an excellent interviewer. The first gig is a big success. For the fourth time that morning, we make the trip between radio station and hotel.

In the hotel room, after once escaping from a near permanent-hold situation on the telephone, a second call to KWXY in Palm Springs expeditiously reaches the news director. He has been briefed, has a press kit in hand, and talks with Hal for about fifteen minutes—more than expected. The taped *actualities* (another of those pesky public relations terms of art) will be cut up and used on newscasts.

It's early for lunch, so we kill time by walking. Bad idea. It's hot, but we keep walking and find a lunch place inside a huge green deco theater building that will soon host Garrison Keillor. Lunch is good, although the indoor-outdoor cafe diminishes the air-conditioned comfort. There is still time to spare before we're due at the day's third broadcast venue, the Business Channel on Sunset Boulevard in Hollywood. Outside, the temperature is still rising; it's definitely hot, but, as they say, "It's a dry heat." After walk number five back to the hotel, Hal negotiates traffic like an LA veteran and has no trouble finding the Business Channel. The time to kill gives Hal a chance to do some souvenir shopping.

Standing in midblock with traffic whizzing by, surrounded by heat-irradiating black asphalt and a shadeless palm tree, Hal appears a more eager shopper than expected. More likely he just sees an air-conditioned building within reach of one quick dash. Either way, a split second later he darts through traffic, jayrunning. Minutes later I catch up.

First stop is a record store (still called that by some, even though vinyl LPs are fast becoming relics). This stretch of Sunset Boulevard is almost totally lacking in glamor or anything of even diverting interest—until we get inside the record store. There Hal is waited on by a California arty type whose voice makes Lily Tomlin's telephone operator Ernestine sound mellifluous. She's quirkily charming, and her knowledge and suggestions about reggae are helpful for Hal. After a modicum of conversation and deliberation, he selects a reggae compact disc for one of his sons. He is duly complimented and praised for his boldness. The other son wants a Jim Everett football jersey, which may be cost prohibitive.

Heading back to the Business Channel, we hear an auto accident ahead. Apparently there are no injuries, so we sidestep the metal and glass detritus on the street and move on. Our wait at the Business Channel allows us to drip dry. Host Skip Lindeman comes straight from his live television show into the reception room for a pre-interview. He has the kind of tanned, toothy good looks that should help keep him in broadcasting for years.

The Skip & Hal Show

Business Channel audiences will probably view the Skip & Hal show three times. No report yet on specific dates as of this writing. The two looked and acted as if they were regular partners. Once again, Hal covers all the bases. He explains various retirement community options, actuaries and the Academy get mentioned more than once, and Hal concludes with an explanation of the value of having an actuary examine CCRCs. The interview is the last engagement of a very successful day. Hal says there is usually one throwaway per media tour, something that either goes badly or that one can sense won't be aired. That is not the case today.

It's so comforting to know that it's a dry heat, because the inside of the car is like a kiln. A direct route to the airport is next. Hal spends the night in Los Angeles, I fly to San Francisco for the next day's business. It is 112° in Los Angeles; in San Francisco it's in the 60s.

Day Two

Day Two may produce the biggest numbers of the media tour. KNBR is the flagship station for the defending National League champion San Francisco Giants. Hal is welcomed with his name on a greeting board in the lobby; on air he will follow the broadcast of a Giants game. Host Peter J. Cooper is engaging and good at putting guests at ease. When the mike goes on, he assumes his authoritative radio voice, with quick delivery, but it's never intimidating. Both he and Hal mention their mothers when explaining and discussing CCRCs. The human touch

(continued on overleaf)

works very well and warms up the interview. Once again, the two segments of the twenty-minute interview pass quickly and without a snag.

It brings to a close a successful media tour that survived suffocating heat, but was not tested by earthquakes, a mild disappointment to this transplanted Easterner. The Academy's efforts may yield still more media attention with even larger audiences. Several television programs that were out of production just for the summer expressed interest in Hal and the topic. And some near misses with the print media may yet bear fruit. Most exciting is the strong likelihood that *Modern Maturity*, with the highest circulation of any magazine in the country, will interview Hal for a major story planned for the fall.

In short, Hal was gotten in every chair on time. Once there, he was listener and viewer friendly, eloquent, professional, and convincing. He transcended the "Actuaries are numbers too" message, and never did he appear the public relations animal who was there just to push a point of view. Hosts were without exception gracious and genuinely interested in the subject. And audiences heard about CCRCs and how actuaries fit into assessing retirement residence options.

One final note. Back at the Academy's Washington office, calls from Hal's viewing and listening audiences were handled by public relations staff. "What are my other retirement housing options?" "Could I get a copy of the profession's CCRC standard of practice to show my retirement community?" "How do actuaries forecast future costs?" All reasonable, thoughtful questions. Our favorite concerns one area Hal neglected to address: "Do CCRCs offer vegetarian meals?"

Krehbiel is public relations specialist for the Academy.

Update Readers' Survey Draws Diverse Comments

Well, the results are in! *Update* Editor E. Toni Mulder is preparing an analysis of our readers' survey for an upcoming issue. On the whole, the *Update* editors were encouraged by readers' responses. Here are some comments that stand out.

"REPORT PROMPTLY ON THE PROGRESS OF LEGISLATIVE AND REGULATORY PROPOSALS/ACTIONS AND REACTIONS FROM LEADERS OF THE PROFESSION."

"DON'T NEED UPDATES ON LEGISLATION—THIS COMES FROM A MYRIAD OF OTHER SOURCES."

"I FEEL THAT *THE UPDATE* TENDS TO BE TOO MUCH LIFE- AND PENSION-ORIENTED."

"PROVIDE MORE PENSION MATERIAL."

"CONSOLIDATE ALL PAGES OF *UPDATE, GOVERNMENT RELATIONS WATCH, ENROLLED ACTUARIES REPORT* INTO ONE FORMAT. TOO MANY SEPARATE PIECES NOW."

"PLEASED WITH CURRENT FORMAT AND CONTENT."

"*THE UPDATE* IS IDEAL FOR KEEPING ACTUARIES INFORMED IN A NON-TECHNICAL MANNER IN DEVELOPMENTS OUTSIDE THEIR AREAS OF PRACTICE."

"I WOULD LIKE TO SEE MORE ISSUES DEBATED ACROSS ALL AREAS OF PRACTICE, RATHER THAN WAIT FOR DEBATES TO EMERGE THROUGH 'LETTERS TO THE EDITOR.'"

"TOO DRY. WHILE INFORMATION [IN *THE UPDATE* IS] WORTHWHILE, A LIGHTER PRESENTATION WOULD BE HELPFUL."

"YOU'RE DOING FINE, I JUST NEED MORE TIME TO READ IT."