

The Actuarial Update

VOLUME 13 NUMBER 11

AMERICAN ACADEMY OF ACTUARIES

NOVEMBER 1984

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Enclosures

Included in this month's issue of *The Update* are the following:

- Government Relations Watch
- In Search Of . . .
- Statements of Actuarial Opinion for Health Service Corporation Statutory Annual Statements
- Financial Reporting Recommendation 11
- Exposure Draft: Financial Reporting Interpretation 8-B

Close-Up on Stan Hughey

The Update staff cornered M. Stanley Hughey for a few moments recently and put a few questions to him designed to acquaint you with the Academy's new president. Hughey is consulting actuary with Tillinghast, Nelson & Warren in Chicago. He resides with his wife Thelma in nearby Northbrook.

The Update: In the best tradition of Barbara Walters, let's start with this question: If you could be anyone in history for a day, who would you be and why?

Hughey: Without any hesitation I can tell you I'd like to be General Eisenhower on the day the Germans surrendered. He must have felt a great sense of accomplishment and a deep feeling of thanks and relief to see an end of the death and suffering after such a long and bitter campaign.

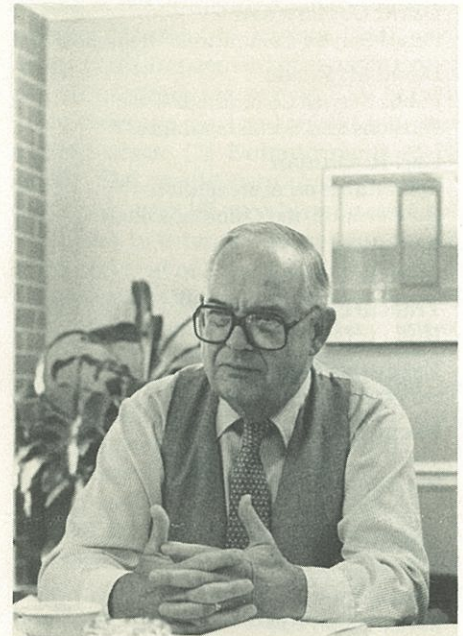
The Update: What's the last book you read?

Hughey: William Least Heat Moon's *Blue Highways*. It beautifully portrays the roots of America—its people, their lives, tribulations, and aspirations.

The Update: What are your priorities during your presidential year?

Hughey: The implementation of the actuarial standards program would have to rank as my highest priority. The Academy has made a commitment to the profession to see this thing through, and we're going to make it a reality. We've made enormous strides under Norm Crowder's leadership, but there is so much as yet undone. Other major and ongoing priorities include increasing the visibility and the recognition of the actuarial profession among our many publics and strengthening communications with other related professions.

The Update: What do you think the 21st century holds for the actuarial profession?



Hughey: Growth, certainly. We will probably see an increase in the number of people entering the profession. But I see growth in another, equally important way. In my judgment our range of activities as actuaries will increase, as our publics become more aware of and develop greater respect for the profession's potential contributions to a broad range of business and public policy debates. Of course that respect has to be earned.

The Update: How do you see the Academy evolving to meet those challenges?

Hughey: Again, communication with the public is a key element. We must not only get our messages out, we need feedback from as many sources as possible so that we can continually address the concerns and needs of society. Besides that, the Academy must continue to contribute in meaningful ways to the growth of the actuarial profession as a profession.

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from the

President

M. Stanley Hughey

Actuarial Clubs: A Good Place To Be

During the last several months, it has been my privilege to visit quite a number of actuarial clubs—from New England to Florida and west to the Mississippi. (Unfortunately, no truly western clubs on this tour!)

The stated purpose of each visit was to discuss the need for actuarial standards and what the profession was doing to meet this need. This is an important topic, of course, but these somewhat rambling thoughts address the subject of the clubs themselves, not my reason for being there.

A history of each of the clubs would be interesting, and perhaps one of our actuarial historians would like to undertake it some day. What a documentary of the growth of our profession that would be.

Based on a limited and quite unscientific sample, I would suspect that most of the histories would run something like this. Two or three local actuaries get an idea that it would be interesting, constructive, and helpful for actuaries in the area to get together periodically for talking shop and getting better acquainted. Calling a few friends, they

set up a meeting, organize a simple program, issue an invitation to actuaries in the area, and an actuarial club is off to a start.

The important themes that would probably be reflected in all of the histories are the desires of actuaries to maintain a continuing education program, to establish good, first name contacts with the other actuaries in the area, and to have a convenient and relatively frequent forum to explore informally the myriad questions that we are all confronted with in our day-by-day activities. If each club tried to write out its goals, there would probably be many variations on these and other themes, but I see this variation as a strength, not a weakness.

The myth about all actuaries being introverted, mathematical whizzes who invariably wear wire-rim spectacles and galoshes on a cloudy day, has long been torpedoed. However, visiting with actuaries on their home ground emphasizes that we are all different. Actuaries are short, tall, dark, light, handsome, not so handsome, beautiful (referring, of course, to our increasing feminine contingent) and, perhaps most important, interested in topical issues affecting their field. Geographic location probably contributes to these differences, but this only adds to the importance and desirability of having the local actuarial clubs strong and meeting regularly.

Actuaries generally are being confronted with many issues—standards of practice, valuation actuary, and actuarial cost methods for pensions, to name just a few. These need thought and discussion among actuaries, and as these get bounced back and forth, the local actuarial club meetings are a good place to be. We should all be attending regularly. Δ

The Actuarial Update

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1985 Grants Competition

The Actuarial Education and Research Fund (AERF) is sponsoring a 1985 grants competition. One or more grants, totalling up to \$10,000, are available to support actuarial education or research projects that advance actuarial science, especially in regard to practical applications. Completed applications are due by February 1, 1985. Awards will be announced in April, 1985.

Proposals are invited from members of the actuarial organizations supporting AERF, from college and university faculty members in the United States or Canada who have teaching and research responsibilities in actuarial or related fields, and others qualified by knowledge and experience to contribute to the goal.

To begin application, a letter should be submitted to the AERF research director outlining the scope of the proposed project. Correspondence should be addressed to Cecil J. Nesbitt, AERF Research Director, Department of Mathematics, University of Michigan, Ann Arbor, Michigan 48109. Δ

Academy Testifies on Medicare

by Christine E. Nickerson

The Academy testified at a recent House Ways and Means subcommittee hearing on the Medicare financing crisis. The testimony, focusing on recommendations by the Advisory Council on Social Security, was presented by Robert H. Dobson, Chairman of the Academy Committee on Health. That committee and the Committee on Social Insurance analyzed those recommendations having actuarial implications.

The Academy agreed with several of the advisory council's recommendations, including the view that insolvency of the Hospital Insurance (HI) Trust Fund is the most critical problem facing Medicare. The fund will likely be depleted before the end of the 1980s. The Academy concurred with the recommendation that the various Social Security programs be funded individually and on a sufficient basis, and the concept that universal coverage would contribute to Medicare's financial security.

The advisory council endorsed proposals to tax health care benefits, and recommended that part of these revenues be earmarked for the HI trust fund. The technical form of this proposal troubled the Academy; a tax-free limit, if there is to be one, should not be based on premiums, but on coverage provided.

The council proposed a diversion of

projected Old Age and Survivors Disability Insurance (OASDI) surplus revenues to the HI trust fund to reduce the trust fund's projected short-term deficit. The Academy noted that Social Security Administration projections do not indicate a long-term surplus in the OASDI fund (though a short-term surplus will emerge). Any reallocation of payroll taxes from OASDI to HI would jeopardize the actuarial balance of the OASDI fund.

The council suggested a gradual increase from age sixty-five to sixty-seven for eligibility, and a subsequent indexation to increases in life expectancy. The Academy agreed that demographic changes are a main reason for Medicare's financial problems: fewer workers will support future beneficiaries. Also, increased life expectancy dictates a longer period of benefit payments. Indexation of retirement age would add stability to the system. However, the Academy noted that different eligibility dates for OASDI and HI would create problems for beneficiaries in setting retirement dates and obtaining health insurance coverage.

Apropos of benefit structure changes, the Academy noted that, in principle, such changes should not deprive covered persons of benefits they currently receive or expect to receive upon retirement. Any necessary reduction should distribute the burden of change as equi-

tably as possible and provide substantial lead time before changes take effect.

The council recommended restructuring benefits under the HI program. The Academy observed that the suggested changes would likely result in a modest net reduction (less than 1%) in program cost. The Academy outlined three significant shifts in the scope of Medicare which would result from changes recommended for the Supplementary Medical Insurance (SMI) program: (1) Enhancement of benefits under the HI program (as part of SMI beneficiary coverage election) would increase benefit costs; (2) Enhancement of HI under SMI would introduce premium payments into HI on a broad scale; the premium is intended to pay for the HI enhancement and support the program generally; (3) Offering optional enhanced SMI benefits would extend the scope of coverage into areas currently covered privately (adverse selection should be considered whenever individuals may elect alternative levels of benefits).

The council proposed the use of voluntary vouchers as an alternative to the current method of reimbursing medical services and as a means of promoting competition in the health industry. The Academy cautioned that there are certain technical problems with the use of vouchers. The most important of these is adverse selection. Another problem is that Medicare enjoys a substantial cost advantage in purchasing hospital services. Unless insurers offering alternatives to Medicare paid the same hospital rates, the premiums could not be competitive.

The council recommended that the SMI deductible be indexed to the CPI to keep pace with inflation and increases in beneficiary income. Currently the SMI annual deductible is fixed at \$75. The Academy agreed in principle that this suggestion would help to stabilize the growth rate of the SMI program, but noted that the CPI might not be the most technically appropriate index for making annual changes to the deductible. The CPI does not reflect cost increase patterns specific to medical services.

In the area of program reimbursement, the council endorsed the use of a prospective payment system and cautioned that the annual rate increases for diagnosis related groups (DRG) rates must be limited. It recommended that



Robert H. Dobson (r) testifies before House Ways and Means subcommittee.

(continued on page 8)

American Academy of Actuaries 1984-1985

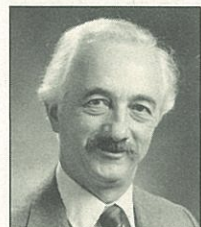


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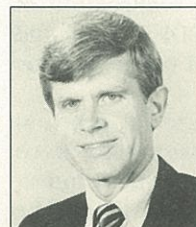
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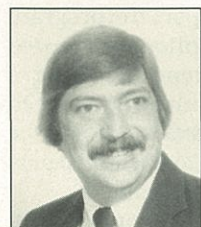
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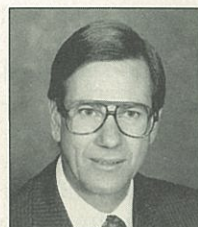
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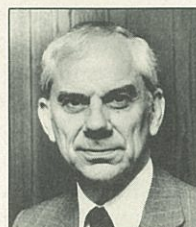
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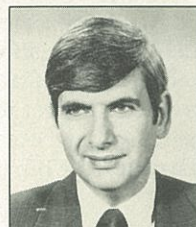
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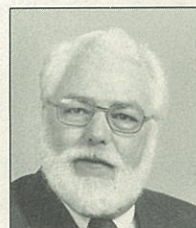
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Thomas M. Malloy



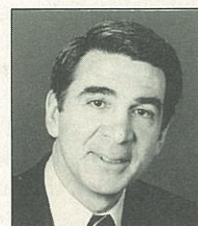
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Richard S. Miller



John O. Montgomery



Stewart G. Nagler



Leroy B. Parks, Jr.



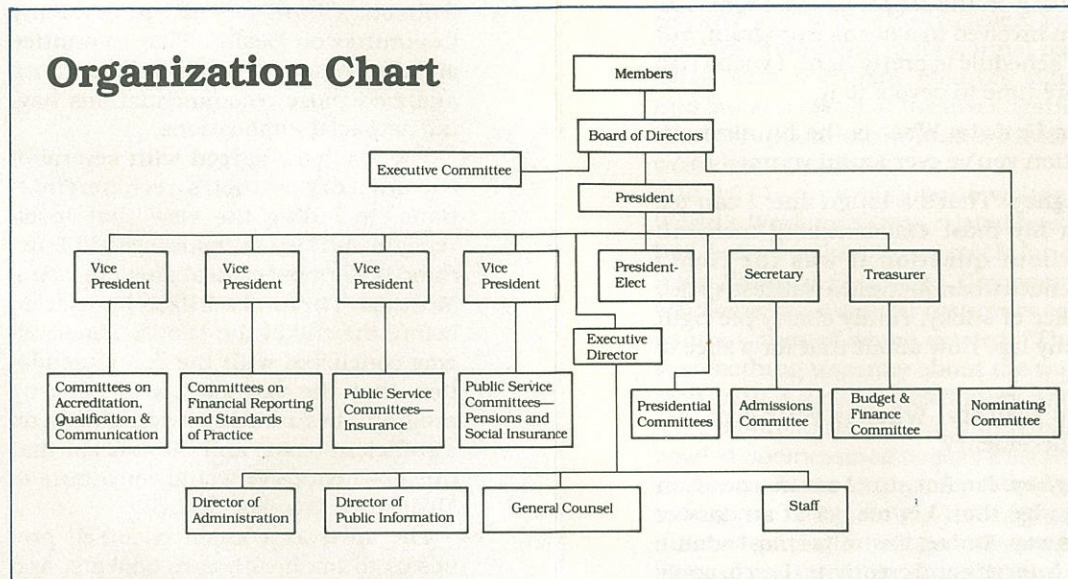
Jerome A. Scheibl



Joseph J. Stahl, II



Benjamin R. Whiteley



Organization Chart

Committee Roster

The Academy committees and their chairpersons are set forth below. The full composition of these committees will appear in the 1985 Yearbook.

PRESIDENTIAL COMMITTEES

Nominating Committee
P. Adger Williams

Committee on Discipline
Harry D. Garber

Committee on Planning
William A. Halvorson

Standards Implementation Committee
Bartley L. Munson

Admissions Committee
James J. Murphy
Note: Reports to Secretary

Budget and Finance Committee
Burton D. Jay
Note: Reports to Treasurer

COMMITTEES ON ACCREDITATION, QUALIFICATION AND COMMUNICATION

Government Relations Committee
Frederick W. Kilbourne

Committee on Qualifications
Walter S. Rugland

Special Committee on Pension Qualifications
Joseph J. Stahl, II

Public Relations Committee
Henry W. Siegel

Committee on Publications
Mavis A. Walters

COMMITTEES ON FINANCIAL REPORTING AND STANDARDS OF PRACTICE

Committee on Life Insurance Financial Reporting Principles
Virgil D. Wagner

Committee on Property and Liability Insurance Financial Reporting Principles
Richard H. Snader

Committee on Principles and Practices and Other Non-Guaranteed Elements
David R. Carpenter

Committee on Pension Actuarial Principles and Practices
Thomas M. Malloy

Committee on Pension Accounting Matters
James F. A. Biggs

Committee on Relations with Accountants
P. Adger Williams

Subcommittee on Actuary/Auditor Relationships—Insurance
Allan D. Affleck

Subcommittee on Actuary/Auditor Relationships—Pensions
George B. Swick

Task Force on Reinsurance Accounting
Ronald E. Ferguson

PUBLIC SERVICE COMMITTEES—INSURANCE

Committee on Health
E. Paul Barnhart

Committee on Health Actuarial Principles and Practices
Ronald M. Wolf

Committee on Life Insurance
Gary E. Dahlman

Committee on Property and Liability Insurance
Jerome A. Scheibl

Committee on Risk Classification
Claire L. Wolkoff

PUBLIC SERVICE COMMITTEES—PENSIONS AND SOCIAL INSURANCE

Pension Committee
Norman S. Losk

Committee on Services to Enrolled Actuaries
Paul L. Engstrom

Committee on Pension Terminology
Michael J. Tierney

Committee on Social Insurance
Francis M. Schauer

Committee on Guides to Professional Conduct
Jack M. Turnquist

Retiring Members of the Board of Directors



William A. Halvorson
Past President



John A. Fibiger
Vice President



Walter S. Rugland
Vice President



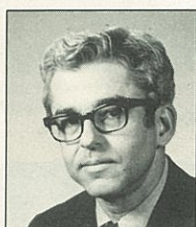
Ronald E. Ferguson



John H. Harding



Willard A. Hartman



Marc M. Twinney



Michael A. Walters

Report: Non-Routine Board Actions

by Carl R. Ohman

The Board of Directors of the American Academy of Actuaries took the following non-routine actions at its meeting on October 8, 1984:

- The board elected Academy officers for the year 1984-1985.
- The board approved a recommendation of the Budget and Finance Committee that the membership dues for 1985 be \$135, an increase of \$10 over 1984.
- The board received a report from the Task Force on Discipline recommending steps both to improve the effectiveness and efficiency of the Academy's disciplinary procedure and steps to enhance the visibility of the disciplinary process. The Board of Directors referred the report to the Executive Committee with instructions to report back to the board in December with its recommendations, including proposed changes in bylaws where needed.
- The board accepted the final report of the Joint Committee on the Role of the Valuation Actuary in the United States and approved a strategy for

implementing recommendations in the report.

- The board adopted health qualification standards, health standards of practice, and standards for interest-indexed universal life—all previously exposed to the membership. The board authorized exposure to the membership of proposed revisions to FRP Interpretation 8-B on the adequacy of property and liability insurance reserves.
- The board authorized the Committee on Pension Actuarial Principles and Practices to undertake a study of the impact of actuarial cost methods on pension funding.
- The board authorized the president to appoint a high level committee on liaison with the NAIC to provide ongoing and usually non-technical communication on a timely and regular basis between leaders of the Academy and leaders of the NAIC.
- The board amended its earlier resolution, authorizing the Academy's participation in a 1989 Anniversary Meeting to recognize that the Council of Presidents now expects the meeting to be held in Washington, D.C. in June 1989. Δ

CLOSE-UP ON STAN HUGHEY

(continued from page 1)

The Update: Do you do any volunteer work, besides your work with the Academy?

Hughey: Oh, over the years I've been involved in a number of volunteer efforts like the Boy Scouts, church functions, serving on the school board. Right now I am involved in a hospice program, but my schedule is pretty tight. I wish I had more time to devote to it.

The Update: What is the funniest situation you've ever found yourself in?

Hughey: That's a tough one. I can tell you my most embarrassing moment. Without question it was the time I attended a banquet and a waitress spilled a slice of sticky, runny cherry pie right in my lap. How about that for a slice of life!

The Update: What is your greatest achievement?

Hughey: I'm not sure I am in a position to judge that. Let me get at an answer this way. Among the traits I most admire are integrity and creativity. I try to apply these qualities to problem solving in my personal and business dealings. If I have, in fact, accomplished that, then that is my greatest achievement.

The Update: Where do you go when you want to get away from it all?

Hughey: My den at home, with a good mystery.

The Update: Who are your favorite mystery writers?

Hughey: I read a fair amount of Agatha Christie and Dorothy Sayers. For a little more intrigue, I like John Le Carre.

The Update: What's the most important lesson you've learned in life?

Hughey: That to understand and work with people you have to strive to see their points of view.

The Update: Last question. How would you like to be characterized by your biographer?

Hughey: I would like it to be said that I was empathetic with others, and at the same time insistent that everybody involved in a project perform up to their full abilities. Δ

Modern Insurance 1910-1920: Over There

by Chris Pankow

Editor's note: The last installment of this series appeared in the August issue of The Actuarial Update.

Though shock waves from the Armstrong Investigation were still being felt, the major New York insurers and those elsewhere were breathing easier. Business was returning to its normal pace, albeit with the many changes signed into law as a result of the investigation. The corruption, the swindles, the deals were over . . . almost.

In 1911, an anonymous writer in *World's Work* magazine related how he had been a salesman of stock for the Inter National Securities Company, a conglomerate of smaller insurance companies—none of which existed. "There is something uncanny about the way a man with a well-prepared story and a few prominent names can induce hard-headed businessmen to part with their money without taking the trouble to investigate sufficiently to find out what they are getting in return." The author himself assumed his firm's legitimacy until a student to whom he tried to sell stock perceived the scam: "My dear sir, I don't suppose you know it, but you are engaged in a swindling operation. . . . I find that your company has no charter to write even life insurance in this or any other state." By chance later that day, the author saw and read an article about a company like his. "It described me to a nicety. I was the 'high pressure' salesman who was depicted as a sort of a beast of prey seeking the innocent and ignorant, and my company was unquestionably the very prototype of the company whose methods were outlined." Many of these companies were being investigated, though it often happened that the presidents and executives of them were difficult to track down.

In 1912 Woodrow Wilson was elected president, New York State passed a fifty-four hour workweek for laborers, the United States had troops in China, Nicaragua, and Cuba to quell revolutions, and the first vitamin, vitamin A, was isolated.

The Nation observed in 1914 that "Several leading life insurance companies have recently devoted considerable effort to the promotion among their policyholders of a mode of using their insurance so as to obtain the greatest

certainly of substantial good. They have drawn the attention of actual and prospective insurers to the advantage of the plan of putting the benefits in the shape of annuities for the beneficiary instead of a lump sum paid at the death of the insured. It is hoped that the annuity plan will find steadily increasing favor."

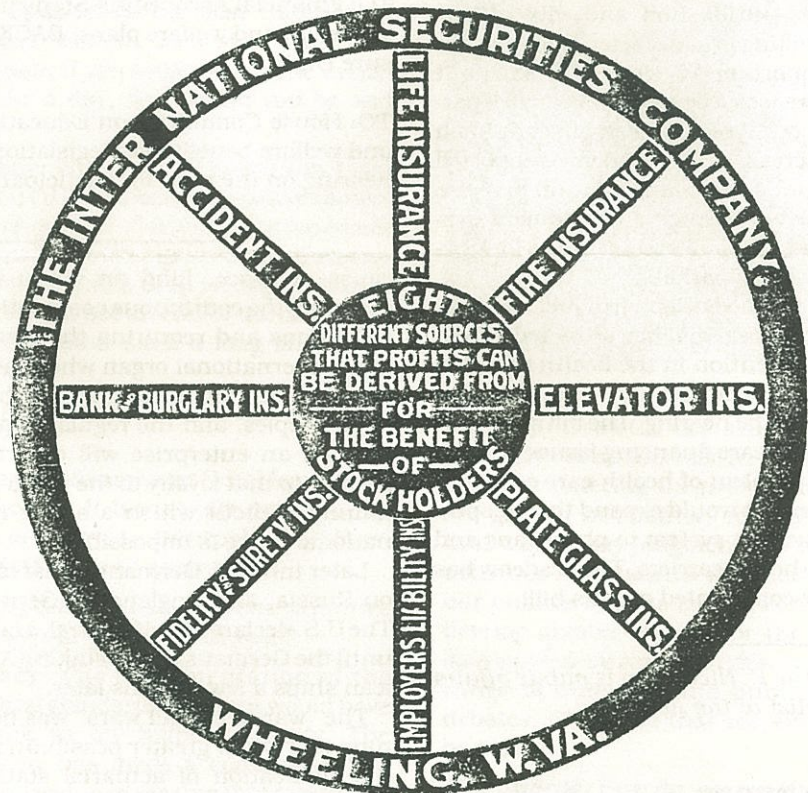
That year, Josiah Royce published *War and Insurance*, a book espousing a sys-

tem of international mutual insurance against war. Royce suggested that finance and arbitration were not powerful enough to maintain peace and should be supplemented by mutual insurance. A board of international trustees would be established with whom nations would insure themselves against war; thus war would be a matter of direct

(continued on page 8)

"A BROAD GAUGE"

As the spokes of the wheel center at the hub—the following illustration will show how the Inter-National Securities Company can operate a multiple of Insurance Companies, and, by their plan reduce the expenses of operating a number of Companies, centering the control under one management, the which will guarantee manifold profits to stockholders.



Some investors earn 3%, 5%, 10%, 20%, and more on their investments. It depends on their judgment in selecting the proper investment, and one that will endure with increasing profit as one year succeeds the other.

This is the Twentieth Century Plan of profit sharing. Co-operation is far more advantageous than working alone; a stockholder becomes part owner in a multiple of Companies, all of which have demonstrated their ability to produce great profits individually.

The accompanying statistics show the profits that come from the operation of the different lines of Insurance that can be written by the Inter-National Securities Company and must convince the most conservative man of the wisdom of this plan. So by doing a little figuring on his own account, he will convince himself that this well conceived proposition will prove to be a substantial and very profitable investment for him.

Actual cover of the Inter National Securities Company's circular showing its eight insurance companies. It did not, in fact, have even one. The potential investor was told how "the most conservative man, by doing a little figuring on his own," would find the company to be "a substantial and very profitable investment."

MEDICARE*(continued from page 3)*

the Secretary of Health and Human Services limit increases to rate changes in the hospital input price index. The Academy concurred with this recommendation, but suggested that an appropriate balance in the rate of increase of DRG amounts be maintained, cautioning against too much reliance on this initiative as a primary means of solving the HI financing deficiency.

The council recommended that physician reimbursement be based on fee schedules rather than reasonable charges. The Academy noted that this suggestion departs significantly from current practice and should not be adopted without careful technical (and policy) analysis. Additionally, cost increases due to causes other than rising fees—utilization and mix of services, billing practices, technology—are also important. Previous efforts to limit fee increases to less than industry patterns have typically been offset by such cost increases. The Academy supported the council's recommendation to revise the current Medicare assignment system and to establish incentives for physician participation.

The Kennedy/Gephardt bill, a legislative proposal that has attracted a great deal of attention in the health care and insurance community, was also discussed at the hearing. The bill addresses both Medicare financing issues and the entire problem of health care cost containment. It would expand the prospective payment system to physicians and private health carriers. The Academy has not yet commented on this bill.

Christine E. Nickerson is public affairs specialist at the Academy.

OVER THERE*(continued from page 7)*

practical concern to all nations. *The New Republic* reviewed the book and said, "Insurance against fire has taught us more than all the other agencies combined of the dangers of faulty construction and inadequate protection." War insurance, said *The Republic*, could do the same against war. "Whatever exceptions we may take to the concrete content of Professor Royce's project, it remains true that he has contributed an idea of extreme importance to the

Checklist of Academy Statements September 1984

Copies are available from the Washington office.

TO: Department of Labor National Pension Forum, September 12, 1984. RE: Pension policy. BACKGROUND: Testimony at forum to commemorate the tenth anniversary of ERISA.

TO: House Committee on Ways and Means, September 13, 1984. RE: Medicare. BACKGROUND: Testimony on the recommendations of the Advisory Council on Social Security.

TO: House Committee on Ways and Means, September 17, 1984. RE: Taxation of employee benefit plans. BACKGROUND: Statement for the record of a hearing on the taxation of employee benefit plans.

TO: House Committee on Education and Labor, September 20, 1984. RE: Age discrimination in employment. BACKGROUND: Statement for the record of a hearing on EEOC proposals on pension accruals during deferred retirement.

TO: Financial Accounting Standards Board, September 20, 1984. RE: Accounting for health and welfare plans. BACKGROUND: Statement in response to FASB Exposure Draft.

TO: House Committee on Education and Labor, September 26, 1984. RE: Health and welfare benefit plan legislation. BACKGROUND: Statement for the record of a hearing on the need for participation, vesting, and funding standards.

cause of peace. Find an object commanding the continuous cooperation of all nations and requiring the creation of an international organ whose activities shall be a significant part in the life of all peoples, and the regular conduct of such an enterprise will contribute notably to that loyalty to the world community without which a stable international peace is impossible."

Later in 1914, Germany declared war on Russia, and England on Germany. The U.S. declared itself neutral, and was until the Germans began sinking American ships a few months later.

The "war to end all wars" was beginning just when greater possibilities for the application of actuarial statistics were being realized. Arthur Hunter, actuary of the New York Life Insurance Company, wrote in 1915: "I have no doubt that the knowledge which the life insurance companies have acquired from their investigations regarding the mortality among their policyholders may be applied by individuals towards lengthening their own lives, but the difficulty arises of getting such information before the public in a form readily understood." (*Literary Digest*.)

The Germans continued to sink American ships, and in 1917, Congress

declared war. "We are apparently not in danger of attack by enemy land forces, but our coast cities may become the prey of predatory visits from submersible craft. . . . The entrance of the U.S. into a war affects insurance contracts of all kinds. The hazards of war are not contemplated nor accepted by [insurance] companies up to the time we became a belligerent. I would advise all policyholders to keep in close touch with the [insurance] companies, through the agents and brokers of the latter, for the purpose of ascertaining exactly what the position of each insurer is." (W. E. Underwood in *The Independent*, 1917.) One insurer replied, "It follows, necessarily, that the companies, not having been paid for such insurance, cannot furnish it."

Influenza claimed the lives of about twenty million people worldwide in 1918, mainly in Europe; 500,000 in the United States. In 1919, the Treaty of Versailles formally ended the World War. Estimated casualties: Allies: 5.1 million dead, 12.8 million wounded, 4.1 million prisoners or missing. Central Powers: 8.5 million dead, 21.1 million wounded, 7.7 million prisoners or missing. United States: 126,000 dead, 234,000 wounded, 4,500 prisoners or missing. Δ