# The Actuarial Update

VOLUME 15 NUMBER 10 AMERICAN ACADEMY OF ACTUARIES OCTOBER 1986


## In this issue



### Enclosures

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

- Government Relations Watch
- In Search Of . . .
- Cassette Order Form

# Congress Recognizes Academy in Risk Retention Act

"(B) a copy of any revisions to such plan or study, as provided in paragraph (1)(B) (which shall include any change in the designation of the State in which it is chartered); and

"(3) to the insurance commissioner of each State in which it is doing business, a copy of the group's annual financial statement submitted to the State in which the group is chartered as an insurance company, which statement shall be certified by an independent public accountant and contain a statement of opinion on loss and loss adjustment expense reserves made by—

**"(A) a member of the American Academy of Actuaries, or**

"(B) a qualified loss reserve specialist.".

(c) EXAMINATION OF FINANCIAL CONDITION.—Section 3(a)(1)(E) (as redesignated by subsection (b)) is amended—

(1) by striking clause (i);

(2) by redesignating clause (ii) as clause (i); and

(3) by adding at the end the following new

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provided in such notice.
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"(1) which—
"(A) was domiciled be
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the enactment of this Act
in any State of the Unite
"(2) which—
"(A) before the date of
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"(B) since such date c
chases its insurance fron
rier licensed in any State;

**RISK RETENTION AMENDMENTS OF 1986**

**by Christine E. Nickerson**

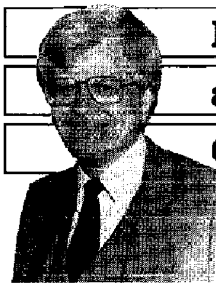
Legislation recently approved by Congress specifically mentions the American Academy of Actuaries in referring to a required statement of opinion on loss and loss adjustment reserves for risk retention groups. The bill, which aims to help address the problems of availability and affordability of liability insurance, would expand the Product Liability Risk Retention Act of 1981 and open up the options of risk pooling and group purchase of liability insurance to corporations, hospitals, trade associations, and municipalities. It would allow a risk retention group chartered or licensed in one state to operate nationwide, without having to be licensed in other states. Additionally, the legislation would preempt state laws prohibiting employers from purchasing liability insurance on a group basis.

Under the proposal, a risk retention group would be required to:

- Submit to regulators in every state in which it operates a copy of the annual financial statement that it files in its domiciliary state. This statement would need to be certified by an independent accountant, with a member of the Academy or a qualified loss reserve specialist providing an opinion on the group's reserves.
- Submit an operating plan to the commissioner in each state in which it plans to do business.
- Exclude coverage for punitive damages or intentional, fraudulent, or criminal conduct to the extent such coverage is prohibited by state law.

Additionally, federal courts would have the clear authority to issue an injunction to stop a risk retention group from operating in all states if the court finds that a group is operating in a hazardous financial condition.

*(continued on page 5)*



## Notes and Comments

**Stephen G. Kellison**

## Special Actuarial Opinions

When most actuaries think of actuarial opinions in the insurance context, they probably think of the statements of actuarial opinion on the several National Association of Insurance Commissioners' (NAIC) statutory annual statement blanks. These statements of opinion are contained in the instructions to the blanks and, thus, wording is standardized. Moreover, the Academy has promulgated qualification standards and standards of practice in these areas; the ground rules are well known and apply broadly across the states.

However, there is another set of actuarial opinions for which the ground rules are not as clearly defined and for which greater diversity exists. This is the world of so-called "special purpose actuarial opinions." I define such opinions as those that are not the result of any NAIC model law or regulation. They exist in only one, or a very small number of states. Typically, such opinions are developed in a state to meet a particular need.

Most special purpose actuarial opinions arise in the areas of pricing and policy design. This probably results from the fact that the NAIC has not chosen to develop standardized language for opinions in these areas as it has for financial reporting. In the absence of NAIC model language, states that wish to use such actuarial opinions have had to develop their own language.

Special purpose actuarial opinions seem to be proliferating. In an effort to call attention to this phenomenon, the Academy published a special state supplement to the July issue of *The Actuarial Update*, which listed opinions we had collected from a variety of sources. Since the publication of this supplement, a number of additional items have been submitted by members. Many of these diverse requirements are of relatively recent origin.

The reasons why such opinions are being used more frequently is not hard to understand. Insurance regulation is a much more complex matter than it used to be. Nevertheless, most state insurance departments are woefully underfunded. In such an environment, the use of actuarial opinions is seen as a regulatory tool allowing insurance departments to stretch their scarce resources further.

There is both good news and bad news in this for the actuarial profession. The good news is that the professional roles and responsibilities of actuaries are being enhanced. The bad news is that, on occasion, we may be asked to sign an inappropriate or poorly-designed opinion. In the extreme, signing such an opinion might even increase the liability exposure for an actuary.

The challenge becomes one of working with regulators to design actuarial opinions so that they give the regulators what they need, while at the same time embodying appropriate professional language from our standpoint. Although this is not always easy, it generally can be done. It *does* require a greater effort than our profession is making at the present time, however.

Also, the actuarial profession should consider trying to standardize more of the wording in these opinions either via prototypes we develop or NAIC models. This need will continue to become more acute as more of these opinions come into existence. In some cases, such as the Rhode Island annuity regulation in which the phrase "sound and safe" appears, new and untested language has been introduced. How such undefined terms might be interpreted in a court of law is anybody's guess.

Special purpose actuarial opinions offer an important new tool to insurance regulators. Our challenge as a profession is to ensure that it is used properly and effectively. If it is, we have the best type of win-win situtation. Not only do the insurance regulators get a better product, but we get increased recognition as a profession, and, most importantly, the public interest is well-served. Δ

## February EA Meeting

The 1987 Enrolled Actuaries Meeting and Exposition, cosponsored by the American Academy of Actuaries and the Conference of Actuaries in Public Practice, is scheduled for February 11-13 at the Sheraton Washington Hotel in Washington, DC.

# Letters to the Editor

## Volunteer Service

The Committee Service Request form was issued in a vacuum. Which committees are suffering from a dearth of volunteers? Are there particular skills that are being sought? What are key emerging issues to be addressed by committees? Which deserve priority?

The Academy has identified a need for more volunteers, now it's time for an article, or articles, in *The Actuarial Update*, describing Academy needs and what members should expect if they volunteer. I, for one, would be more likely to volunteer if I knew to what I was being asked to respond.

Alfred O. Weller
Short Hills, New Jersey

*Editor's note: The Academy received 104 responses from members eager to serve on any number of committees. That number is, by far, the largest response ever received by Academy leadership to a call for volunteers. Committee guidelines provide for the rotation of one-third of a committee's membership every year. Hence, committees are always in need of new blood. As to emerging issues and priorities,* The Actuarial Update *and the "Government Relations Watch" regularly cover committee activities and developing, priority issues.*

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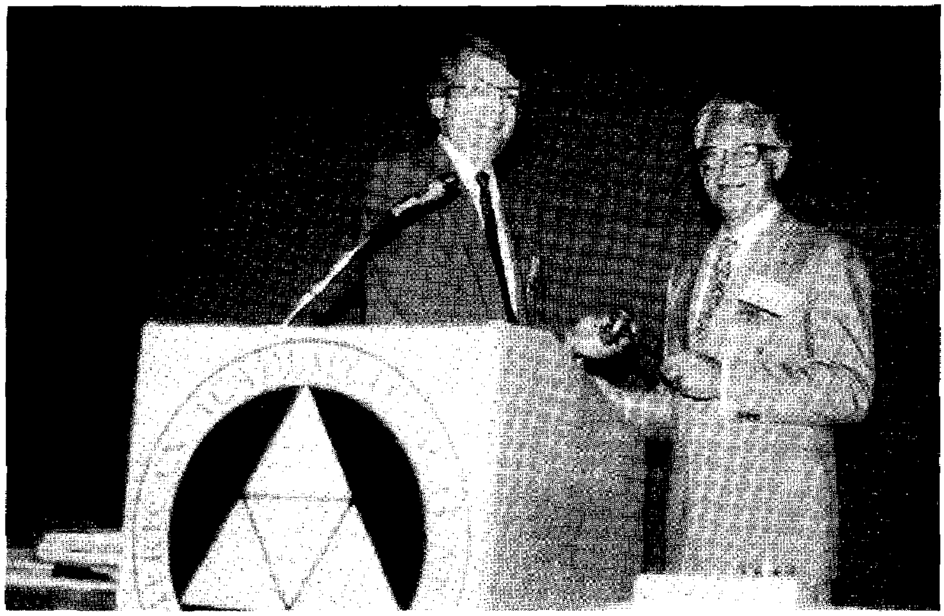
**The Update** welcomes letters from readers. Letters for publication must include the writer's name, address, and telephone number, and should be clearly marked as Letters to the Editor submissions. Letters may be edited for style and space requirements.



**President Preston C. Bassett receives the gavel of office from outgoing President Bartley L. Munson at the annual meeting business session.**

# Annual Meeting Round-Up

Some 325 actuaries gathered in San Antonio, Texas, September 22–24, 1986 for the annual meetings of the Academy and the Conference of Actuaries in Public Practice. The riverwalk may never be the same again.

The two and one-half day meeting showcased panel sessions covering such topics as FASB—Employers' Accounting for Pensions; Our Aging Workforce; Small Firm Management; The Valuation Actuary—Views of the Industry and Regulators; Health Care Communication Issues; When Should Casualty Consulting Actuaries be Retained?; FASB 87; Various Viewpoints on Continuing Care Retirement Communities; Asset/Liability Valuation Methodology for Life Insurance Companies; and Use of Plan Assets in Corporate Acquisitions, Leveraged Buy-Outs and Take-Overs. Not to mention a mock trial on actuarial liability and an actuarial seance!!!

The Academy's business session featured a discussion of the past year's accomplishments and future goals by the leadership, as well as the traditional passing of the gavel to President Preston C. Bassett by Bartley L. Munson, immediate past-president. In keeping with past practice, a transcript of the business session will appear in the *1986 Journal*, which should be available for distribution in March 1987.

The business and panel sessions were tape recorded and are available on cassettes from the Conference Cassette Company for $8.00 per cassette tape, plus $3.00 postage and handling. We refer you to the order form enclosed with this issue of *The Update*. Δ

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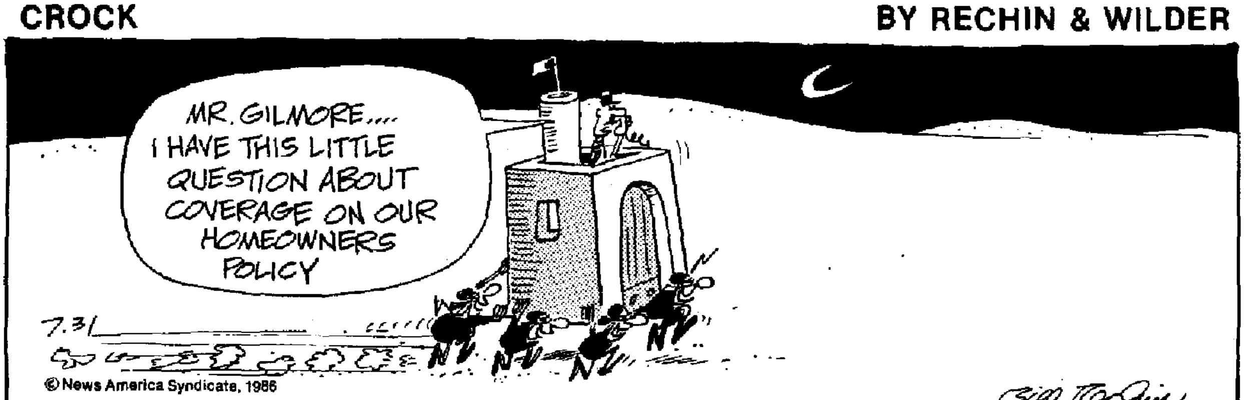

# Non-Routine Board Actions

**by Robert H. Dobson**

At its meeting on September 5, 1986 in Nashville, Tennessee, the Board of Directors took the following non-routine actions.

- The individuals named below were elected to serve as officers during the coming year: John A. Fibiger, president-elect; Burton D. Jay and Mavis A. Walters, vice presidents; Daniel J. McCarthy, treasurer; Robert H. Dobson, secretary.
- The board approved the Interim Actuarial Standards Board (IASB) Nominating Committee recommendation of Ronald L. Bornhuetter, as chairperson of the IASB, succeeding John A. Fibiger.
- The board approved an increase in dues to $160 per year, effective January 1, 1987. (More on this action will appear in dues notices, which are mailed December 1).
- The chairperson of the Joint Program Committee for the Enrolled Actuaries Meeting reported to the board on its activities.
- The board changed the name of the Committee on Property and Liability Insurance to the Committee on Property and Liability Issues and approved corresponding changes in the committee charge.
- The Health and Welfare Subcommittee of the Committee on Health was elevated to full committee status and the reporting relationship was revised such that the new committee will report to the same vice president as the Pension Committee.
- The board discharged the Special Committee on Pension Qualifications, with thanks. Δ

# NAIC Report

**by Gary D. Simms**

The Fall Zone Meeting of the National Association of Insurance Commissioners (NAIC) was held September 7–10 in Des Moines, Iowa. Welcoming representatives of the insurance industry, regulators, and others were newly-appointed Iowa Insurance Commissioner William D. Hager, former general counsel of the Academy, and NAIC President Josephine M. Driscoll, commissioner of the state of Oregon.

As regular readers of *The Update* are aware, a key actuarial focus of NAIC meetings are the deliberations of the Life and Health and Casualty Actuarial Task Forces. However, these groups did not meet in conjunction with this meeting. The Life and Health Actuarial Task Force met, instead, October 9–10. The Casualty Actuarial Task Force is scheduled to meet again at the Winter National Meeting in Orlando, Florida, December 7–11.

The issue of liability insurance cost and availability was the center of discussion in Des Moines and was highlighted by the appointment of two new advisory committees to the Legal Liability Insurance Task Force, chaired by Fletcher Bell, Kansas insurance commissioner. One new advisory committee, comprising representatives of the insurance industry, business organizations, major trade groups, and legal organizations, will be required to undertake a major study of the liability insurance issue. A second advisory committee, focusing on the availability of statistical information, is due to report its findings at the December meeting in Orlando. The focus of efforts by that group involve an analysis of what forms of information are already available, how that information can be analyzed effectively and efficiently, and how data can be used to monitor the impact of tort reform.

In addition, the issue of data availability was raised in a general session, which featured representatives from the Insurance Services Office (ISO) and the Risk and Insurance Management Society (RIMS). Carole Banfield, representing ISO, detailed the efforts undertaken by that organization to accumulate and analyze industry data, noting with specificity those questions being raised in current debate that are not answerable based on current data availability. Jon Harkavy of RIMS called for an "independent source" of industry data and suggested that the NAIC could properly undertake this role.

On another front, the NAIC's State and Federal Health Insurance Legislative Policy (B) Task Force took a major step toward the drafting of model legislation covering preferred provider organizations (PPO). The model bill under consideration would be designed to authorize the establishment of PPOs, as well as set standards and guidelines for their operation.

Zone meetings will be terminated by the NAIC at the end of 1987; beginning in 1988, the NAIC will limit meetings to June and December national affairs.

*The author is the Academy's general counsel.*

# Checklist of Academy Statements—August 1986

Copies are available from the Washington office, American Academy of Actuaries, 1720 I Street, N.W., 7th Floor, Washington, DC 20006.

TO: Senate and House conferees on tax bill, August 7, 1986. RE: Pension legislation. BACKGROUND: Letter on alternative minimum tax on difference between pension contribution and FAS 87 pension expense.

TO: Financial Accounting Standards Board, August 25, 1986. RE: Insurance accounting. BACKGROUND: Material submitted to FASB at open meeting on accounting for universal life insurance.

TO: Senate and House conferees on tax bill, August 26, 1986. RE: Pension legislation. BACKGROUND: Letter on proposed penalty for "overstated" liabilities on pension plans. Δ

# Coming Soon . . .

- An interview with Dennis M. Kass, Assistant Secretary for Pension and Welfare Benefits, Department of Labor; and
- A special subject supplement, which will present in summary fashion the annual reports of the Academy's committees for 1985-1986.

**RISK RETENTION**
*(continued from page 1)*

Earlier House and Senate-passed risk retention bills had differed in several ways. Meetings between House and Senate staff to work out differences in the proposals led to the following compromises:

- The risk retention amendments would not preempt state laws that set financial responsibility requirements for employers engaging in certain activities. Under this amendment, if a risk retention group had not qualified as a licensed, admitted insurer, a state could still say that an employer having obtained coverage through the risk retention group did not satisfy its financial responsibility requirement. The Senate bill had originally lacked such a provision.
- The Commerce Department would be required to submit a report to the Congress on the effect, if any, that the risk retention amendments have on easing the liability insurance crisis. The report would also be required to examine the extent, if any, to which states initiated discriminatory actions against risk retention groups.

The bill now awaits President Reagan's signature. The Administration has supported the proposal, and presidential approval is expected. The effective date of the legislation would be the date of the signing of the bill by the President.

Numerous Congressional hearings have been held during the past year to examine the liability insurance crisis. The risk retention bill is one of the few proposals addressing this issue that is likely to be signed into law during the 99th Congress. Hearings and investigations into the liability insurance problem are certain to continue in the next Congress. Issues likely to be examined include profitability of the property and liability industry, data collection, underwriting practices, and the McCarran-Ferguson Act.

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*Nickerson is the Academy's public affairs specialist.*

*Share your actuarial war stories with your colleagues. Your professional-related anecdote should be true, short and humorous. Address your submission to Managing Editor,* The Actuarial Update, *at the Academy's Washington address.*

# 1987 AERF Grants Competition

Once again in 1987, the Actuarial Education and Research Fund (AERF) is sponsoring its annual grants competition. One or more grants, ranging from $5,000 to $10,000, will be available to support actuarial education or research projects. Funds may be used to compensate grant recipients, themselves, or to cover expenses incurred carrying out the project.

AERF and its five sponsoring organizations—the American Academy of Actuaries, the Canadian Institute of Actuaries, the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries—see as the goal of the competition the encouragement and publication of research in actuarial science, with particular emphasis on practical applications. To this end, proposals are invited from members of the sponsoring organizations, faculty members of U.S. or Canadian universities or colleges who have teaching and research responsibilities in actuarial or related fields, and other individuals who are qualified by knowledge and experience to advance such research.

Applications outlining the scope of the proposed project should be submitted, in writing or by telephone, to Mark Doherty, acting research director of the AERF. Doherty will send the applicant full information on applying for a project grant, including a formal application form. Doherty's address is % Actuarial Education and Research Fund, 500 Park Boulevard, Itasca, IL 60143. His telephone number is (312) 773-3010.

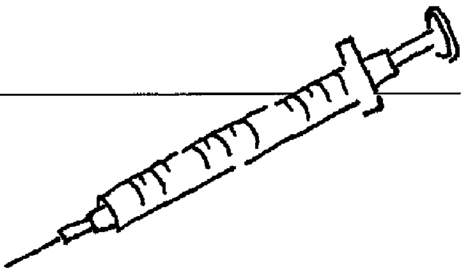
Completed applications are due February 1, 1987. They will be evaluated by an awards committee drawn from the actuarial profession. Awards will be announced in April 1987. Δ

## Quote Without Comment

"Someday I am going to start a Society for the Preservation of Actuaries. They are the most maligned men and women in our business, and possibly in any business I know. They tend to have sneaky senses of humor that creep up on you when you least expect it, and blow your pomposity apart. They are also very brilliant people. I promise never to join the crowd that makes fun of actuaries—unless, of course, they deserve it."

—Don Barnes
"As I See It: What Does This Person Believe?"
*National Underwriter*, September 6, 1986

# War Stories



## Actuarial Vaccine

Here's my actuarial war story—way back to World War II, when I was serving as a 2nd Lieutenant in the Office of the Surgeon General, U.S. Army.

Singlehanded, I wiped out a plague epidemic, as shown in an annual report. I merely checked back to the station hospital report that showed these cases and found that the entire line for continuing cases, new cases, and remaining cases of respiratory diseases in one weekly report had been typed on the preceding line (plague). This was doubled-checked by examining the immediately-preceding and following reports as to continuing and remaining cases.

Oh, that all serious actuarial problems could be solved so completely!

Robert J. Myers

## How's That Again?

During vacation time we had to fill in with a temporary clerk in our Agency Actuarial Department. It just wasn't working. During the first morning there had been several snafus and a general lack of understanding on some simple projects. We had tried to overlook that and decided we could live with it for a week. However, the final straw came that afternoon when I phoned the department and realized we were being identified as, "Agency Allergy."

William C. Cutlip

## Milton 18, Destiny 0

**by Mary-Lou Weisman**

The Actuarial Update *reprints this essay with the kind permission of the author and* The New York Times, *in which it originally appeared on June 18, 1986.*

Westport, Connecticut—My Uncle Milton has been a new man ever since the Internal Revenue Service notified him of the date he is going to die.

Milton turned 70 recently and was therefore obliged by law to begin to withdraw money from his pension plan. His accountant advised him not to take all the money out at once but instead to write to the IRS for a payment schedule. The IRS actuarial tables, his accountant explained, would take account of Milton's age, as well as other personal information, and suggest a payment schedule based on life expectancy.

Uncle Milton did not at first appreciate the deeper implications of being in possession of such information. He just thought it was smart tax planning—that is, until he opened the envelope and learned that he had 18.58 years to live.

The actuarial table from the IRS indicated that the 18.58 figure represented his life expectancy as a married man, using the joint and survivor annuity approach. Should he suddenly find himself not married for any reason, his life expectancy would plummet instantly, and presumably without notification, to 13.67 years. (My Aunt Lily reports that Milton, always a thoughtful husband, has recently been even more solicitous than usual.)

It was not until he fed the 18.58 figure into his own computer and came up October 2004 that Milton realized he had broken the ultimate taboo, he now knew the unknowable—his death date.

The instant Milton read the news, he was suffused with a profound sense of relief and well-being. He had not realized just how much "the big countdown" had been preoccupying him. The moment he learned his dying day, the awful burden lifted. The identical news, received from some lesser, fly-by-night Federal agency, like the Environmental Protection Agency or the Transportation Department, might not have carried the same authority. But there it was in writing from the IRS.

There are people who would just as soon not know that kind of information, even if it comes from a reliable source. This Apple computer bite from the tree of knowledge is not without historical precedent and makes some people nervous. Not Milton.

He sees it more as a matter of timing than mortality. He agrees that people of tender years should not know their dying day. What's the point? They all think they're immortal anyway. Death, Uncle Milton says, is wasted on the young. But for the mature individual, knowing can be a boon.

Certainly Milton seems to be blooming in the very shadow of his own definite mortality. He hauls out his fateful day at every opportunity. People mention dates for the next world's fair or election or Marvin Hagler fight, and there's Milton, joining in with a chirpy, "I'll still be alive then." When the projected date clearly lies beyond his dying day, such as his grandchild's college graduation, Milton interrupts the conversation with equal good cheer to offer his regrets. Owing to what he calls "the prior engagement," he won't be able to attend, he says.

Knowing his death day seems to have given him what life has heretofore failed to provide—an unshakable confidence in the future, and a real sense of purpose.

Milton has also found that there are some solid, practical advantages to having his exit timed. He has written away for season tickets to the opera and he stopped buying cashmere sweaters in favor of Shetland. At his dental appointment last week, he opted for the middle-price bridge work with the semi-impervious enamel.

But the greatest benefits may be spiritual. Knowing his dying day has given Milton the ultimate peace of mind. Now, when he wakes up in the morning with a scratchy throat, he doesn't panic. He knows this isn't the "Big It." It can't be. He's got nearly 18.58 years left. Stress and anxiety have virtually disappeared from his life. He has the blood pressure of a youngster.

Occasionally, though, when he's tinkering with the guest list for the funeral, or reworking the eulogy, it occurs to him that he might just make it past October 2004, that simply knowing when he's going to die may have added years to his life.

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# Halley and the Roots of Actuarial Science

In addition to being the first scientist to predict the periodic return of Halley's comet, Edmond Halley also made an early foray into the realm of actuarial science.

Although best known for the comet that bears his name, Halley was a man of wide interests and knowledge. In a letter to 17th century scientist Robert Hooke, Halley, in an aside, dabbles in the science of actuarial statistics. After summarizing the comparative statistics for Paris and London of births, marriages, deaths and population density—the last facilitated by Halley himself pacing off the dimensions of the city of Paris on foot—he concludes: ". . . it will from hence follow, supposing it alwaies the same, that one half of mankind dies unmarried, and that it is necessary for each married Couple to have 4 children one with another to keep mankind at a stand."

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*The quote from Halley's epistle is taken from* Comet, *Carl Sagan and Ann Druyan, New York: Random House, 1985.*