THE ACTUARIAL update

AMERICAN ACADEMY OF ACTUARIES

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Close-Up on John Harding

John H. Harding will assume the post of president at the Academy's Annual Meeting on September 30. Harding is president and COO of National Life Insurance Company in Montpelier, Vermont. He met recently with Update *editors to discuss his presidency and his vision for the Academy.*

THE UPDATE: What goals have you set for your Academy presidency?

HARDING: Recognizing that there are very real limitations built into a 1-year term of office, I have narrowed my focus to four key initiatives. First, I will devote as much time and energy as necessary to see that the Actuarial Board for Counseling and Discipline (ABCD) is in place and fully operative. The ABCD is an important element in the profession's years-long move toward embracing all that it means to be a profession. As such, its demands of me will be a top priority.

Incoming President John H. Harding

Second, I want to continue working to advance the Academy's insurer solvency agenda, which got a good start during my term as president-elect with the position statement developed by our blue-ribbon task force.

Third, I will do whatever I can to strengthen the practice councils, both in terms of their inner workings and their relationship with other actuarial organizations. The practice councils will be at their most effective when they are the means, the conduit if you will, for an ongoing dialogue between the Academy and the other U.S. actuarial bodies.

Finally, I think we must pay more attention to the Academy's sometimes neglected publics. Historically, the Academy has played an effective role in shaping public policy dialogue at the national level; we need to devote more resources to playing a strong role at the state level, especially on regulatory matters. Insurance company leadership needs to hear more from the Academy, particularly company managers who are themselves actuaries.

THE UPDATE: You mentioned strengthening our efforts at the state level. Do you envision that being accomplished by enhancing our involvement with the National Association of Insurance Commissioners (NAIC) or actually working directly with state legislators?

HARDING: Given the size of the Academy staff, I believe the best

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Academy Testifies on Pension Benefits

By Christine Sand

Pension plan terminations have increased at an extraordinary rate since the enactment of the Tax Reform Act of 1986, reported Academy Secretary-Treasurer Thomas D. Levy in Academy testimony on August 4 before the Labor Subcommittee of the Senate Committee on Labor and Human Resources. "Last year there was one new plan for every twenty plans being terminated," he stated. Levy's comments were based, in part, on the Academy's survey of enrolled actuaries—results of which were released on June 24 at a *Forecast 2000* news conference at the National Press Club in Washington, D.C. (See August *Update*.)

The Academy testified at the invitation of Senator Howard Metzenbaum (D-Ohio), subcommittee chairman, who opened the hearing quoting the Academy survey results, to which he added a call to restructure our private pension system. Levy, who was testifying on behalf of the Academy's Pension Committee, was accompanied by committee member Jeff Schwartzmann. According to the survey, Levy explained, more than 30,000 employers have terminated their defined benefit pension plans

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FROM THE **president**

Narrowing in on Academy Effectiveness

by John H. Harding

In this era of consumerism, most successful organizations have learned that listening to customers is fundamental to their success. The focus of that listening must center on understanding customer expectations and then meeting or exceeding them.

Only a slight translation from this general theme needs to be made in the context of a membership service organization, such as the Academy. As the organization whose primary focus is public interface, we must look to our own membership from several different points of view. It is most important that we know your expectations, so that we can do our best to meet them. We must also look to you as key participants in the process of meeting those expectations.

Many of the same people form another set of customers, the leadership of the other North American organizations that represent actuaries. Are we working on the right issues, and are we working together in the most effective and efficient manner?

Much has been done in recent years to address the expectations of these organizations, and the feedback process has been positive and consistent.

It is time, however, to make sure that we understand the expectations of our membership. To this end, we have begun a process of listening. This summer, 3,000 actuaries received questionnaires that included an early probe to begin to define the issues. Similarly, I have asked the leadership of the other organizations to help me understand the feelings of their membership concerning their expectations.

Of course, the range of the expectations of Academy activity is perplexing. To some, we should be doing far less. To others, we should be doing far more. Part of this range exists because of varying personal beliefs about the role of the Academy as an interface organization. Another part comes from diverse ideas about the impact on public issues that an organization like ours can have, in the context of many other organizations that reflect competing points of view.

I believe that, in order for the Academy to be effective, we must begin to narrow the range of those expectations.

For example, the guidelines for making public statements, as published in pages 44–47 of the 1992 Yearbook, provide a reasonable framework for the scope of such statements and the process for developing them. However, they give evidence of the broad range of possibilities:

- "Clearly, a public statement of knowledge unique to actuarial science should be the primary focus in the profession's public pronouncements." From this starting place, it does permit statements beyond the narrow areas where the actuary's knowledge is unique. Question: What should be the limits to this extension?
- "A statement generally should not take positions on the social and political implications of issues; however, in certain circumstances, it may not be possible to divorce social or political implications from actuarial considerations." Question: Are there times when we should become advocates, rather than advisers?
- "There may be some issues that have actuarial implications that are better dealt with by trade associations, insurance companies, or individuals. Public statements that appear to be self-serving will be less effective, but the Academy should not hesitate to speak out on matters that involve legitimate, professional self-interests." Question: To what extent should the Academy become an advocate for a larger actuarial role in some issues?
- There is considerable procedural language that defines the desired process for developing and exposing for comment a public statement, but how often does the public arena allow for a deliberate process? However, there is exception language that allows for timely response, when required. Question: Should not the process assume that timely response is the rule, rather than the exception?
- There are countless issues that could be commented upon by our profession today. As we work toward effective use of our resources, should we try to make statements regarding a high percentage of them, or should we target our efforts to a smaller number of critical issues? Question: If we target, how should we involve the membership in picking the issues?

The answers to these questions come in a wide range of gray shades. The effectiveness of the Academy in the eyes of its membership must come through narrowing the range.

This editorial is the first of three by incoming Academy President Harding that will appear in these pages.

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

Academy Meets with FASB

By Christine Nickerson

Actuaries and accountants discussed a number of topics of mutual interest at a recent meeting of members and staff of the Financial Accounting Standards Board (FASB) and representatives of the Academy and the Actuarial Standards Board (ASB). The group met at FASB's headquarters in Norwalk, Conn. on June 25.

Present-Value-Based Accounting

FASB has undertaken the examination of accounting measurements based on the present values of future economic benefits or sacrifices (interest methods). FASB project manager Wayne Upton reported that after the August 1991 public hearing on the project, there was not much action. The project is now moving again, he said, and FASB plans to issue a preliminary views document because more details and clarification are needed. FASB is looking at the topic comprehensively, he said. The board is not focusing on insurance alone, but insurance is an important part of the inquiry.

Upton said that the objective of measurement is fair value—present value that reflects market value and interest rates. When asked if FASB plans to do a field test, he said that would depend on reaction to the preliminary views. He said FASB hopes to be well into the drafting of the preliminary views document by the end of the year.

Market-Value Accounting

FASB project manager Robert Wilkins outlined the development of this project. FASB has been moving toward additional market value information in financial statements. In December 1991, SFAS 107, *Disclosures About Fair Value of Financial Instruments*, was issued. This new statement will require footnote disclosure of the fair value of financial instruments, with some exceptions. Currently, FASB is working on a limited-scope project dealing with the recognition of the fair value of financial instruments. This project could require mark-to-market accounting for most debt and equity securities that are held as assets. FASB is also considering how to address mark-to-market accounting for certain liabilities that support such assets. In the current proposals, insurance liabilities are not required to be reported at fair value.

Academy representative Barbara Snyder discussed the need to address both sides of the balance sheet. She said that the Academy has followed the development of fair value accounting over the last several years, and she believes that fair value accounting for assets only would be inappropriate. She volunteered the skills of the actuarial profession to assist in this project, saying that actuaries have the tools and training to value liabilities, especially those kinds of contingent liabilities that have appeared most difficult to FASB. Academy representative David Hartman reminded the group that there are differences between property and casualty insurance and life insurance that must be kept in mind as FASB continues its discussions of fair value reporting.

Postemployment Benefits

FASB is monitoring questions arising from the issuance of SFAS 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions.* FASB staff person Ken Dakdduk reported that there are no plans to issue a Q & A document because of the success of the field test, which was incorporated into SFAS 106. The field test helped anticipate questions that could arise. Also the Q & A documents for SFAS 87 and 88 (pension accounting) should be helpful, he said. The standard itself has a large section on "basis for conclusions" that provides guidance, he added. Dakdduk said he is taking questions from practitioners about application of SFAS 106. Interpretative guidance will come from staff—these

Continued on next page

letters TO THE EDITOR

Forecasting a Fiasco

The *Actuarial Update* (July 1992) reports that the Academy is calling for "reforms that would minimize the risk of insurance company insolvencies." This is a laudable effort, to be sure, that could minimize disappointment for thousands of policyholders, as well as preserve the long-term credibility and viability of the institution of insurance. And it is an appropriate use of the actuary's unique skills to evaluate the future financial consequences of promises being made today.

But why aren't actuaries using their analytical skills to evaluate the largest "insurance company" of all time, the one that is the most likely to default on its promises: Social Security, including Medicare. This program now costs 15% of payroll, and will eventually cost between 33% and 50% of payroll.

The greatest insurance fiasco in history is going to occur in the 21st century when we are forced to admit that the children of the baby boom generation cannot produce enough to fulfill the promises that Social Security is making to their parents, the baby boomers. Can't we foresee the social and economic consequences of this debacle? Are we waiting for some other profession to reveal this truth?

There is no need to accept my view, or the dissenting views of others, about this impending disaster. Each actuary is well-equipped personally to evaluate the scenario based on readily available information. Why not invest a few hours of your time and do it?

A. Haeworth Robertson
Washington, D.C

CALENDAR

1992 Valuation Actuary Symposium
September 17–18

Casualty Loss Reserve Seminar
September 20–22

Academy Annual Meeting
September 30

Actuarial Standards Board
October 7–8

Conference of Consulting Actuaries Annual Meeting
October 19–20

American Society of Pension Actuaries Annual Meeting
October 25–28

Society of Actuaries Annual Meeting
October 25–28

Casualty Actuarial Society Annual Meeting
November 15–18

HARDING, *continued from page 1*

use of our resources is stepping up our NAIC involvement. But there are other selective opportunities, as well. We need to build better bridges at the top levels of the American Insurance Association, the American Council of Life Insurance, the Insurance Information Institute, and the Health Insurance Association of America, to name just a few off the top of my head. The Canadian actuaries do this kind of interaction with counterpart and constituent organizations particularly well. They are a good model for us.

THE UPDATE: Describe for us your style of leadership.

HARDING: My leadership style is to be equal parts compass and communicator; that is, I articulate a direction. Once we're all headed down the same path, I am very involved to the extent that I make sure we stay on the road to our destination. I haven't been involved in trenches actuarial work for some 14 years, so I've had plenty of time to perfect this!

"The relationship between regulators and industry is one of cops and robbers . . . that's the history we've got to stop fighting."

THE UPDATE: Why did you first become active in the Academy?

HARDING: I got involved probably the same way most of us do. I was interested in a specific issue and got active in the Academy in order to address that issue. Once drawn in, I became enthused by what the Academy can and does accomplish when it's operating at its most effective level.

THE UPDATE: In your case, what was the issue?

HARDING: It was putting in place standards of dividend principles and practices for mutual life insurance companies, which were adopted by the Academy Board of Directors in 1980 on Halloween.

THE UPDATE: Is there some significance to that date?

HARDING: I never really thought about it, but you know, I became president of my company on April Fools' Day, so who knows? On a more serious note, my work on the dividend principles and practices standard got me involved in debating larger issues of standard setting, updating, and enforcement. The establishment of the Actuarial Standards Board (ASB) was a logical outgrowth of those discussions; and I am pleased to have played a part in that landmark development.

THE UPDATE: Would you call that the greatest stride that the actuarial profession has made in the last decade or more?

HARDING: Without question, it's one of several critical, even watershed, events for the profession over the last 10 years.

THE UPDATE: And the others?

HARDING: The establishment of a uniform disciplinary process with the ABCD as a central element is another important stride for the actuarial profession. Perhaps none of this would have been possible, though, had the profession not been successful at developing and cementing a strong relationship among the six organizations representing actuaries in the United States and Canada.

THE UPDATE: As an insurance company president, what is your view of the relationship between the actuarial profession and the insurance industry?

HARDING: I think the role actuaries play within the insurance industry has deteriorated somewhat over the last two decades. We don't play the predominant role we once did, and the insurance industry has suffered because of it. We need to reassert the legitimate place of actuaries within the industry. I'm not sure this makes good interview copy, but I believe it to be so.

THE UPDATE: It's great copy. By all means, continue.

HARDING: There was a story recently in *Probe*, written as I recall by an agent, that illustrates my point. The author, Alan Press, in addressing insurer insolvencies posed the question: Where were the actuaries when all this was going down? Walt

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FASB, *continued from page 3*

are "unofficial" responses, he said. A formal, official interpretation would have to come from the board, he said, but such a move is not contemplated.

FASB board members asked if the necessary databases are available for small groups. The Academy responded that such data are a real problem—they are not always available. With large groups, many approximations are used, and in time this approach may be applied to small groups.

GASB/Accounting

Penny Wardlow, research manager for the Governmental Accounting Standards Board (GASB), discussed progress on GASB's projects on pension reporting and on accounting for public employee retirement systems. She said the board believes that pension accounting for governmental entities should be as consistent as possible—but that there are difficulties with respect to statutory requirements. She said GASB is looking at implementation problems. The board plans to issue exposure drafts that will incorporate changes to GASB 5. Wardlow asked about the current status of the ASB standard on selecting economic assumptions for measuring pension plan obligations, saying that the board is interested in citing this standard.

Other discussion items included FASB's project on accounting for reinsurance. Academy representative Diane Wallace said that there is a need to clarify timing of income provisions and to consider the question of risk transfer requirements. The group also discussed the project on pension plan accounting for governmental investment contracts. FASB member Bob Swieringa asked about the experience of actuaries in this area. ■

Rugland, among several others of us, wrote a thoughtful response, which concluded with the telling statement that "Actuaries were out of the game." That says it all. In essence, as company management moved from traditional ways of managing the insurance risks, other professions, legitimately so, began to play a much larger role. Historically, the actuary was both a specialist (tending to the details of risk assessment) and a generalist (looking over the solvency management process throughout the company). With the involvement of other professions, that generalist responsibility became very much played down. Actuaries were, in essence, "out of the game."

THE UPDATE: Are we making up that ground, in your view, with our work on professionalism issues like standards and the uniform counseling and disciplinary process?

HARDING: Absolutely. There is a perceived void, and our work in these areas is going a long way toward filling that void.

THE UPDATE: Is the insurance industry leadership accepting of what the profession has been doing?

HARDING: Far more so than 5 years ago. Today, most life and casualty insurance company CEOs recognize that enormous damage can be done to the insurance industry by some other CEO not managing company solvency. They are far more receptive today to mechanisms being put in place that help manage insolvency risk . . . and the same is true of the regulatory community.

That takes me to what has almost become a theme recently. Whether you're talking about insurance regulation or the regulatory system in general in the United States, we face a serious problem. The relationship between regulators and industry is one of cops and robbers. It's not that way in Canada, the United Kingdom, Japan, or Germany. In those countries it's a much more collaborative relationship, more of a partnership.

And that kind of relationship can have several very beneficial results. First of all, we're going to see continuous unpredictable change, certainly for the rest of my career. Our current regulatory system simply cannot cope with fast change. There must be a far more effective mechanism with mutual trust and one with an understanding that the fundamental question is not whether something is *legal*, but whether it's *right*. We can't do it all by simply changing the insurance industry, but that's not a bad place to start.

THE UPDATE: Perhaps some of the recommendations in the Academy's insurer solvency statement will have some impact on what you are describing.

HARDING: I hope so. I've been intrigued and pleased so far with the response by both some members of company management that I've exposed this to—because I haven't exposed it broadly in company management yet—and also by the regulating states, where they do understand some of the issues. Right after articulating that understanding what you will next get is a war story saying why cooperation didn't work. And why you couldn't trust those guys. That could be from the company or from the regulators. The point is that's the history we've got to stop fighting.

THE UPDATE: On to a more personal question. What is your ideal weekend not spent in your office?

HARDING: I don't spend many weekends in the office. In fact, I rarely take paper home with me. I take ideas home with me. It's my preference to work on ideas, not paper. The best paper time I have is on an airplane, because generally speaking it's uninterrupted.

THE UPDATE: Tell us about the process involved in "working on ideas." Do you set aside a specific time to problem solve, or is it back-burner thinking that goes on all the time?

HARDING: There are a couple of ways I do it. First of all, for good or evil, I have multichannel thinking. It's rare that I concentrate on just one thing at a time. There's foreground thinking and background thinking, but it's all going on up there. I worked out something well over 40 years ago that is a big help. Just before I go to sleep at night, I think of a complex, difficult problem—one that is not emotionally loaded. When I wake up in the morning, I think about it again. I exercise first thing in the morning for about 45 minutes, during which time I try to recall what's been churning around in my head all night. And usually, I find my thinking and my problem solving associated with that issue well advanced. That makes for a very productive 45 minutes.

John Harding shares a light moment.

Another thing that helps is to get away from it all occasionally. I have a camp that is just a few minutes from my home on a lake. It's very quiet. Even for Vermont, it's quiet. So quiet, I didn't even know it was there, although it is only 10 minutes away. My wife and I live out there for about 6 months every year and on most weekends. It's just a time to set aside the high-speed activity of the day, change gears, and get things back in context.

That kind of setting allows me to indulge in what I call directional thinking.

THE UPDATE: Directional thinking?

HARDING: Let me explain by example. Most jokes are written starting with the punch line; the setup is then crafted to get you to the laugh. In essence, it's tackling a problem, all the while knowing where you want to come out. That's the opposite of inside-out thinking, where you doggedly follow and search a path to whatever outcome presents itself. Direc-

Continued on next page

tional thinking I do best when I have sufficient quiet time.

THE UPDATE: Is there anything else, any other message you would like to convey to the membership of the Academy either about yourself personally or your vision of the organization?

HARDING: I want to strive to stay in touch with the Academy membership as much as possible, to get a better understanding of what they expect and need from us. I want to know how well we are meeting those expectations. Perhaps members have some expectations that are unrealistic, some we may never be able to satisfy. If so, we've got to find that out and work together to constructively narrow that range. Or broaden it, as the case may be. I get into this more in my editorial (See page 2), but suffice it to say here, there is something more we can do, and that something more is listen. Like any good consumer company, we've got to listen. And then we've got to communicate what we're doing with what we've learned. That can only make the Academy better, stronger, and even more effective.

THE UPDATE: Thank you, John, for your time this afternoon.

HARDING: I've looked forward to this for some time. It's been enjoyable. ■

Standards Outlook

by Christine Nickerson

Highlights of the Actuarial Standards Board's (ASB) July 14–15 meeting include approval to release exposure drafts of proposed standards on data quality and on selecting economic assumptions for measuring obligations.

Data Quality

The proposed standard on data quality was first released as an exposure draft in April 1991. It was developed by a task force of the Specialty Committee of the ASB. The proposal addressed the responsibility of the actuary to select reasonably among alternative types and sources of data, the actuary's responsibility when relying on data supplied by others, and the actuary's responsibility to disclose deficiencies in data. The ASB received thirty comment letters on the draft. These comment letters raised a number of questions and concerns about the proposed standard. Issues raised included the definition of data, accuracy and completeness of data, reliance on others, and documentation and reporting.

The task force revised the proposed standard in light of these comments and suggestions. Task force chairperson Phil Miller told the ASB that the task force believes the revised proposal has been substantially improved as a result of these changes. At the same time, he said, the changes were deemed significant enough to require a second exposure of the proposed standard. The board suggested clarifying and strengthening several sections of the standard, including adding a provision that the actuary should consider whether data are so inadequate that they cannot be used to satisfy the purpose of a study.

Pension Plan Assumptions

Mary Adams, chairperson of the Pension Committee of the ASB, told the board that the proposed standard on the selection of economic assumptions for measuring pension plan obligations represents more than 3 years of study, discussion, and drafting by the committee. She said that the Pension Committee considers the proposal to be a foundation for a standard—a foundation which itself could change in the course of exposure, comment, and debate. The topic it addresses is characterized by so many complex issues and divergent actuarial approaches that obtaining consensus has presented the committee with extraordinary difficulties, Adams said.

As stated in the standard, its purposes are: to provide additional guidance to actuaries who select economic assumptions for measuring obligations under defined benefit pension plans; to amplify provisions of Section 7 of *Actuarial Standard of Practice (ASOP) No. 4, Measuring Pension Obligations*, and to modify the provisions of Subsections 7.1 and 7.3 of ASOP No. 4 relating to the selection and use of implicit economic assumptions; and to enhance a user's understanding of the actuarial communication that documents the process and the results of a measurement of obligations of a defined benefit pension plan.

The ASB reviewed the proposed standard and suggested several clarifications. The board discussed at length the recognition of the effect of income tax (the tax premium) on the investment return assumption. The proposed standard contains an illustration to explain this concept. The standard also contains other illustrations that provide examples of the methods and approaches outlined. The board approved exposure of the proposed standard, and recommended that hearings on it be held in conjunction with the fall actuarial meetings.

The ASB will hold its next meeting in Dallas on October 7 and 8.

NATIONAL CONFERENCE ON AUDITING POSTRETIREMENT BENEFITS

The American Institute of Certified Public Accountants (AICPA) and the Academy are cosponsoring a conference on the implementation of SFAS 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*. The conference will focus specifically on the implementation problems confronting both auditors and actuaries. The conference seeks to further define the important working relationship of the actuary, the auditor, and corporate management. The conference will present useful planning techniques used by both the actuary and the auditor—techniques you can use in your own practice. Learn how to reach the conclusions of SFAS on a real-time basis.

The conference will be on November 10, at the Hyatt Regency O'Hare in Chicago. For further information about the conference, please call Rachel Dichter, Project Manager, AICPA, at (201) 938-3567.

Capitol
VIEWS

Pension provisions are included in the Unemployment Compensation Amendments Act, which was signed into law on July 3 by President Bush. The provisions permit any portion of a distribution from a qualified pension or annuity plan or a tax-sheltered annuity to be rolled over tax-free into an individual retirement account or another qualified employer plan. The new law requires a trustee-to-trustee transfer and a mandatory withholding requirement for those distributions that are not transferred directly, thereby eliminating the current 60-day limitation on tax-free rollovers to IRAs. Any transfers to qualified employer plans would be contingent on the sponsor's agreement to accept the distribution. The new law also imposes a 20% withholding tax on distributions that are eligible to be rolled over, but are not transferred directly to eligible plans. It is estimated that this withholding proposal will raise $2.1 billion for unemployment insurance over 5 years. Under the Act, the plan administrator is required, reasonably soon before making an eligible rollover distribution, to provide written explanation of the transfer, rollover, and withholding provisions, as well as information on lump sum income averaging and any new unrealized appreciation. The Department of Treasury is directed to develop a model notice. Although the Act encourages money to stay in the pension system, it also adds complexity for both employers and employees. Operational compliance with the new provision will be required as of January 1, 1993. Plan amendments will not be required until January 1, 1994.

An effort at pension simplification is included in the Revenue Act of 1992, an urban relief tax package. The package, H.R. 11, contains a simplified definition of highly compensated employees, more timely determination of cost-of-living adjustments, safe harbors for 401(k) discrimination compliance, retrospective testing approach for 401(k) deferral percentages, availability of 401(k) plans to not-for-profit entities, clarified application of Section 415 limits to governmental plans, and uniformity in the vesting rules for single employers and multiemployer plans. In a letter to Congress, the Academy Pension Committee praised the members for their efforts, but stressed that this movement toward simplification needs to be continued. The bill is now in the Senate. (*Request* PS-92P-5).

Comments on the Federal Insurance Solvency Act of 1992, H.R. 4900, were prepared by the Academy's Life Insurance Financial Reporting Committee and Property-Liability Financial Reporting Committee. Representative Cardiss Collins (D-Ill.), chairperson of the Subcommittee on Commerce, Consumer Protection and Competitiveness of the House Energy and Commence Committee requested the comments to clarify the diverse actuarial issues that congressional staff may address during further consideration of the bill. On August 4, the full committee approved a bill requiring federal agencies to study the financial health of the nation's insurance industry. *(Request PS-92G-3).*

Decisions on the small-plan audit cases before the United States Tax Court were handed down by Judge Clapp on July 14. The court upheld the use of 5% pre- and post- retirement interest rate assumptions in both cases (Wachtel, Lipton and Vinson & Elkins), and a retirement age assumption of 55 in one case and 62 in the other. The opinions state that "each of the . . . challenged assumptions was reasonable, and the actuarial assumptions and methods used were reasonable in the aggregate." Therefore, the IRS is precluded from requiring a retroactive change of assumptions.

For more information on the regulatory or legislative actions noted above, contact Christine Sand at the Academy's Washington office.

NAIC MEETING SUMMARY

The premier of Bermuda, Sir John Swan, evoked the beauty of his coral island in his keynote address to the National Association of Insurance Commissioners (NAIC) summer meeting, held at the Washington Sheraton Hotel June 7–11. The following is a summary of the many topics of interest to the actuarial profession that were discussed by the more than 2,300 attendees.

The Life and Health Actuarial Task Force recommended exposing proposed changes to the NAIC model "Actuarial Opinion and Memorandum Regulation." A new model regulation, "Regulation for Valuing Life Insurance Policies," will be exposed.

In addition, the task force recommended, and the Life Committee approved, exposing four new actuarial guidelines for comment.

The Long-Term Care Insurance (B) Task Force is considering the issue of nonforfeiture benefits for long-term care insurance. The Ad Hoc Actuarial Group led by Bart Munson submitted its report to the task force. Commissioner Earl Pomeroy of North Dakota thanked Munson and the group, and said the task force wanted to expose a draft of a specific nonforfeiture approach at the fall NAIC meeting in Cincinnati.

The Risk-Based Capital Working Group discussed an outline of a model risk-based capital formula for life and health insurance. Cande Olsen of the industry advisory committee presented several versions of an annual statement schedule to reflect the risk-based capital results, and Terence Lennon of New York, chairman of the working group, indicated that the formula's application to fraternals and Blue Cross/Blue Shield plans would be looked into. An exposure draft of the formula will be issued by September.

The risk-based capital formula for property/casualty insurers is not quite as far along and may not meet the September deadline for exposure and December adoption, according to Vincent Laurenzano of the New York Insurance Department, the working group's chairman. David Hartman, who gave the property/casualty industry advisory committee's report to the task force, noted that there were differences between the property/casualty formula's and the life/health formula's asset risk factors.

The Casualty Actuarial Task Force voted to recommend to the Blanks (EX4) Task Force that the 1992 annual statement instruction language on "reliance" be amended in accordance with language developed by the Academy and the American Institute of Certified Public Accountants (AICPA). The Blanks Task Force subsequently adopted the recommended language. Following the recommendations of the actuarial task force and those of its Blanks Task Force, the NAIC Financial Condition (EX4) Subcommittee approved the changes in the annual statement instructions for actuarial opinions.

The casualty actuarial task force also discussed developments undertaken by its advisory committee to determine whether there can or should be a common definition of allocated loss adjustment expense.

Warren Cooper, advisory committee chairperson, explained that there are different definitions for financial statement reporting and for ratemaking, and that definitions even vary among ratemaking organizations. Task force members are particularly interested in developing a consistent definition so that when data are published, accurate comparisons can be made between different states, between different lines, and between different companies.

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since January 1990. Forty percent of these employers have not replaced their plans, Levy stated, leaving their workers without employer-provided pension coverage. Of those employers who did replace plans, 90% of these were defined contribution plans.

At the conclusion of his remarks, Levy was asked why large employers had shifted to defined contribution plans. He replied: "It is primarily due to increased regulation. Prior to 1986's Tax Reform Act, an employer could have one actuarial study of the plan every 3 years. Today, a large plan cannot function with fewer than five different sets of assumptions every year to comply with the regulations." Levy then expounded upon the frustrations of dealing with an endless parade of regulations. "A plan sponsor cannot get the changes made for one set of regulations before new rules are set in place," noted Levy.

Chairman Metzenbaum referred to defined contribution plans as "do it yourself" plans; he asked Levy to explain why defined benefits provide a better level of retirement. Among his remarks, Levy stressed the security provided by a defined benefit plan, which has benefits that are used strictly for retirement rather than for current consumption.

The Academy urged the adoption of its three-part plan to help restore choice to the private pension system. Labor Subcommittee members expressed a good deal of interest in working with the Academy as Congress continues to deliberate the problems facing retirement income security.

The survey of defined-benefit plan terminations was the result of an 18-month effort by the Academy. Academy government relations staff put the survey reports in the hands of important public policy makers, and public relations staff worked to publicize survey results through the actuarial profession's *Forecast 2000* public relations program. Levy's committee testimony received same-day television coverage on CNN and CBS's Washington affiliate; nationwide publicity of survey results included stories in the *Wall Street Journal, USA Today*, the *Washington Post*, and the *Chicago Sun-Times*.

Copies of the Pension Committee's testimony can be obtained from the Academy's Washington office by requesting PS-92P-6.

Thomas D. Levy testifies before the Senate Labor Subcommittee, flanked by Employee Benefits Research Institute President Dallas Salisbury. Academy Pension Committee member Jeff Schwartzmann is at the left.

PBGC Q & A

James B. Lockhart, executive director of the Pension Benefit Guaranty Corporation, recently responded to several questions posed by the Academy regarding the problems and challenges facing his agency. A portion of that exchange is printed here.

Q. The PBGC is on record: It will not guarantee pension funds invested in annuities in the event of insurer insolvency. However, if employers were willing to pay an extra premium to have the PBGC guarantee such annuities, might the PBGC reconsider its position? What if the law mandated that the plan could buy an annuity only from insurers that are domiciled in states with guaranty funds or have quality reinsurance?

A. The PBGC has determined that ERISA does not authorize it to guarantee benefits provided under irrevocable annuity contracts purchased from insurance companies, in the event that the insurer is unable to make payments under such contracts. In addition, the PBGC is opposed to the establishment, by legislation, of a federal guarantee of annuity contracts.

The regulation of the insurance industry and guarantee of annuity contracts historically have occurred at the state level. Establishing a federal guaranty system for an industry that is not now regulated by the federal government could lead to the kinds of moral hazards that resulted in the savings and loan bailout.

Further, the design of a sound program for the federal guarantee of annuities would involve complex, contentious, and probably intractable issues. The PBGC believes that, through efforts by the states, guarantee funds, and insurance industry, the necessary protection can be achieved without the need for federal involvement.

Q. What are the PBGC's proposed changes to the minimum funding rules? What is the PBGC's rationale for these changes?

A. Minimum funding changes would speed up the pension funding process so that underfunded plans will be fully funded in 10 to 20 years rather than the 30 years it now takes. A sponsor of an underfunded plan would have to pay the highest of three calculated amounts: the amount under the original 1974 rule, a stronger version of the 1987 deficit reduction contribution rule, and a new solvency maintenance rule.

The new solvency maintenance rule would require a sponsor's pension contribution to equal the amount paid out in benefits plus interest on the underfunding. It is designed to correct the problem of rapidly dwindling assets created by an increasing number of retirees and a shrinking active work force, and would be phased in over 5 years to prevent undue burden on companies.

As to the rationale, even though companies follow existing funding rules, their pension underfunding is growing. In just 1 year, total underfunding in defined benefit plans increased from about $30 billion to $40 billion. Of that total, $13 billion—compared to $8 billion the previous year—is associated with financially weak companies and represents a serious risk to the PBGC.

Q. Some actuaries think that only underfunded plans should be required to make quarterly contributions. Does the PBGC have a stake in requiring that plans funded beyond termination liabilities make contributions quarterly?

A. For underfunded plans, the quarterly contribution requirement protects the interests of plan participants and the PBGC. The quarterly contribution requirement will increase collections from companies that might otherwise miss an entire annual payment. Missed quarterly contributions by underfunded plans serve as an early sign that a plan sponsor is in financial difficulty. Requiring overfunded plans to make quarterly payments adds little to the PBGC's security. ■