

THE ACTUARIAL update

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Appraisal Standard Called a "Universal Conscience"

by Alan Kennedy

In appraising the value of an insurance company for merger and acquisition (M&A) or other purposes, actuaries now have a standard that will "make the work more defensible and less arbitrary," says an investment banker who commissions many actuarial appraisals. Actuarial Standard of Practice No. 19, Actuarial Appraisals, released in final form last month, "gives the whole exercise a universal conscience," adds the banker, Leandro S. Galban, Jr., of Donaldson, Lufkin and Jenrette, New York City.

Galban's firm employs ten professionals full time on insurance-company mergers and

acquisitions and raising capital for insurance companies. He participated as an interested observer (one of two investment bankers) on the task force that developed the standard of practice on appraisals for the Actuarial Standards Board (ASB). The actual drafting was done by the task force's nine actuaries, most of them consultants involved in M&A work for life/health or property/casualty insurance companies.

"I felt that development of a standard was really for the benefit of buyers, sellers, and the investment bankers who represent them," recalls Galban. "In the large-scale mergers and acquisitions of the 1960s and 1970s, investment banking companies

sought to commission actuarial appraisals as an aid to valuing insurance properties and to facilitating price negotiations. Big firms like Tillinghast and Milliman & Robertson became adept at the appraisal process. But at the end of the day, you couldn't be sure that all parties to the transaction were comfortable with the process as a basis for negotiation. You couldn't go to a single source and find out what the actuary was supposed to do. It got so that if you mentioned 'actuarial appraisal,' people would say, 'forget it.' That's how mushy the process had become."

In the background of that mushiness, according to Galban and actuaries on the task force, were two issues—client pressures and competing philosophies. Robert D. Shapiro, a life-insurance consulting actuary who headed the appraisal standard task force, agrees that "there is great pressure on people in consulting firms. Unless you have clear standards, you may be encouraged by the selling firm to take careful note of what's good about the company and look less hard at what's not good. The other side, the prospective buyer, may push for the opposite kind of evaluation. What I hoped to develop in this standard was to make sure that if people are going to be pushed, there is a wall beyond which they can't be pushed." Shapiro adds, "If an

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New Standards Binders

You will soon receive a second actuarial standards binder which, in combination with materials previously sent to you by the Academy, should furnish you with a complete set of actuarial standards of practice, qualifications standards for public state-

ments of actuarial opinion, and the code of professional conduct. Separate booklets containing the procedures for adoption of additions and modifications to the qualifications standards and the code of professional conduct are in production, and will be forwarded to you in the near future for inclusion in your actuarial standards binders. Until you receive these booklets of procedures, please assume that the procedures for the development of standards of professional conduct

and qualifications standards that appear on pages 375-78 of the Academy's 1991 Yearbook remain in effect. ■

**This issue unveils our
long-planned, much
labored over new design.
We're well pleased with
the result, as we hope
you will be.**

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FROM A GUEST president



Looking Ahead

by Ruth F. Frew

As many of you know, the American Society of Pension Actuaries (ASPA) celebrated its twenty-fifth anniversary last year. Much was accomplished during our first twenty-five years. To give you a little perspective, our membership has grown from three original members in 1966 to more than 3,000 today. Our Education and Examination Committee now sponsors courses and prepares examinations for hundreds of students every semester. There has been similar dramatic growth in our government affairs activities. Our conferences have expanded, not only in size, but also in the variety and frequency of offerings. Our annual conference routinely attracts over 1,000 individuals, with hundreds more attending our other annual meetings: the eastern and western regional conferences, telecast, and business owners' conference.

As ASPA moves into its second quarter century, I would like to acquaint you with some of its long-term goals.

First of all, ASPA remains committed to the preservation and enhancement of the private pension system. We have opened communication lines with several key members of Congress, congressional staffers, and executive-branch personnel in the employee benefits area.

We believe that only by being proactive can we truly have an impact on government policy. An example is ASPA's development of a benefit-security proposal, which we are currently discussing with the Labor Department. If accepted as the basis of legislation, this proposal would enhance benefit security for participants in qualified plans that cover fewer than 100 participants, while plac-

ing little, if any, additional burden on plan sponsors who administer plans responsibly.

Our Government Affairs Committee is unique in that it is cochaired by an actuary and an attorney. Combining legal and actuarial expertise in one committee has proven to be a very effective strategy. The actuary who cochairs our Government Affairs Committee also sits on the Academy's Pension Council. In addition, one of the committee members serves on the Academy's Pension Committee to better coordinate joint efforts where feasible. Both of these liaisons serve to enhance cooperation between the Academy and ASPA with respect to pension actuarial issues and have led to joint testimony and joint amicus briefs on several occasions.

As part of our commitment to the private pension system, ASPA is committed to the development of a national-retirement income policy. For the past two years, we have been developing a series of papers that we expect to release later this year. These papers cover the various aspects of personal savings, replacement ratios, work after retirement, the Social Security system, and the private pension system. We believe attention should be focused on the need to establish a national retirement income policy, and ASPA has chosen to take the lead in this effort. By setting forth one version of an integrated national retirement income policy, our papers will be an excellent starting point for discussion.

ASPA remains committed to providing continuing education to its members. We are proud to have been the first actuarial organization to have developed and implemented a formal continu-

ing-education recognition program. The program began on a voluntary compliance basis January 1, 1985. As of January 1, 1991, satisfaction of the program requirements is mandatory for all who become credentialed ASPA members after 1990.

ASPA is also committed to expanding basic educational opportunities for members. We are in the process not only of revising our existing pension examination program, but we are also developing a program that will provide education opportunities in the health and welfare benefits area.

ASPA continues to be committed to strengthening the actuarial profession by working with the other North American actuarial organizations. We welcome the opportunity to participate on the Council of Presidents and to foster the spirit of cooperation, which was institutionalized with the signing of the Working Agreement in 1990. One idea that has enhanced understanding and working relationships among the actuarial organizations is the idea of having the presidents and presidents-elect of the Casualty Actuarial Society, Conference of Consulting Actuaries, Society of Actuaries, and ASPA serve as members of the Academy's Board of Directors.

ASPA's leaders recognize that we bring a unique perspective to discussions with the other organizations, particularly in the pension field, where we represent all retirement benefit areas, not simply defined benefit pension plans. Our membership consists of actuaries, consultants, and administrators. We believe this provides us with the ability to serve fully the pension community.

During 1992, my goal is to ensure that ASPA activities are directed toward carrying out our statement of purpose: to educate pension actuaries, consultants, and administrators, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy.

Frew is president of the American Society of Pension Actuaries.

Statements of fact and opinion in this publication, including editorials and letters to the editor, are made on the responsibility of the authors alone and do not necessarily imply or represent the position of the American Academy of Actuaries, the editors, or the members of the Academy.

In Appreciation

The Academy bid farewell in mid-November to General Counsel Gary D. Simms. After having served the actuarial profession for a near decade, Gary has moved on to combine private law practice and association management consulting.

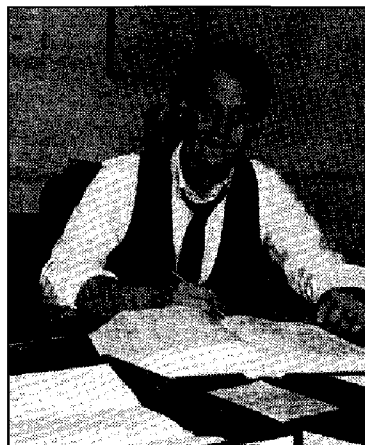
Gary's tenure at Academy headquarters in Washington was characterized by strong leadership and a number of significant achievements. While working as staff lawyer, he directed for five years the Academy's government relations program, bringing it from its infancy to young adulthood, at which time its growth and maturity, indeed, its successes demanded the attention of a senior level staffer devoting full-time attention and resources to the profession's government relations activities. He was acting executive director during 1989, while a search committee interviewed candidates for the executive vice presidency of the organization. Thereafter, he took on the title of general counsel and director of operations.

Among his many work products were our antitrust guide and the numerous amicus briefs to state supreme courts and the U.S. Supreme Court he filed on the Academy's, in fact, the profession's behalf. But those projects that make up the body of his contribution to the actuarial profession in one way or another touch on professionalism.

He drafted several modifications to qualifications standards and continuing education policies. Moreover, he drafted the establishing documentation (bylaw amendments and implementation procedures) for the Actuarial Standards Board, as well as its predecessor body, the Interim Actuarial Standards Board. He was the key staffer working on the creation and adoption of the new code of professional conduct. And, he provided lead staff support during the creation and adoption of the Actuarial Board for Counseling and Discipline.

"It is my work in the standards and discipline area of which I am most proud," Gary remarked recently. "My association with the actuarial profession has provided me no end of personal and professional satisfaction. I have thoroughly enjoyed the work—not to mention the opportunity to make some friendships I will always value."

We know you join us in expressing our thanks to Gary for his dedicated service to the actuarial profession. We wish him well in this new direction his career is taking him. ■



Gary D. Simms, former Academy general counsel.

Appointed Actuary Booklet

A handy, four-page booklet, *The Role of the Appointed Actuary in the United States for Life Insurers in 1992*, is available upon request from the Academy's Washington office.

Actuaries in the United States, as in many countries, play several roles in the financial management of life and health insurance companies. In 1992, the United States joins Canada, Australia, and the

United Kingdom in broadening that range of responsibilities by designating one actuarial position set apart by legislation and practice: the Appointed Actuary.

The Standard Valuation Law now requires life insurance companies to appoint an actuary who will submit the annual statement of actuarial opinion on the adequacy of reserves. For many insurers, the appointed actuary's opinion will "include consideration of the adequacy of the insurer's assets that support the reserves."

Life actuaries who may need to discuss their new statutory duties with their employers and staffs will find this booklet useful. ■

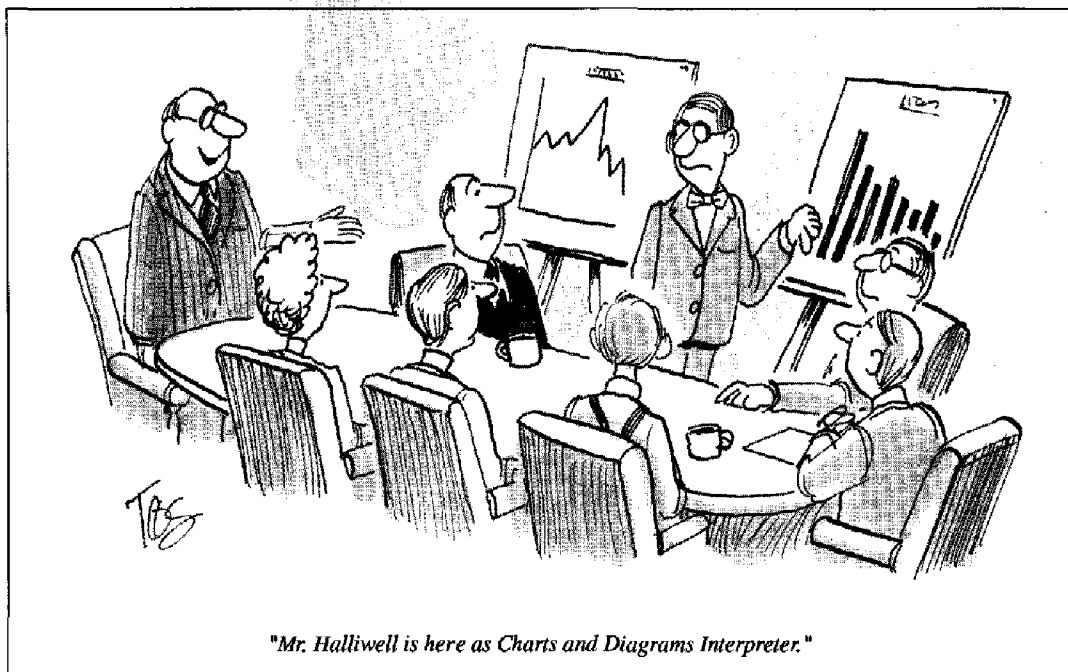


Illustration by Andrew Toos

NAIC's Risk Based-Capital Formula for Life Insurers

by Jeanne Casey

Regulators now have in hand a proposed formula to help them determine the total capital an insurance company needs in light of the risks it assumes. The National Association of Insurance Commissioners (NAIC) received for testing a risk-based capital formula developed by an industry advisory committee to the Life Risk-Based Capital Working Group of the NAIC. Actuaries served on the advisory committee and were the chief architects of the formula. There is a comparable industry advisory group working on a risk-based capital formula that will apply to property/casualty insurance companies.

The life risk-based capital formula was pretested on a database of 674 companies before its public release, December 8, 1991. In the months ahead, the advisory committee will continue to test the formula using more complete data, some of which are not available in the annual statement, and develop sensitivity tests for specific factors included in the formula.

The risk-based capital concept is not new. The premise is that a company's capital and surplus requirements should be linked to the riskiness of its investments and products. Companies have used such formulas internally to set capital and surplus for strategic growth and diversification. State regulators have used simple formulas as diagnostic tools to determine whether insurers have sufficient capital in light of their size and risk profile. Rating agencies such as Moody's have applied risk-based capital measures in the rating of companies. In fact, various risk-based capital formulas have been used by companies, regulators, and rating agencies for nearly a decade.

In 1982, Wisconsin adopted a very simple formula involving only four factors that were

applied primarily to premiums for different lines of business. The formula yielded what was called "compulsory surplus." By law, an insurer would have to have the greater of either this compulsory surplus or the minimum surplus indicated by the Wisconsin regulation or be deemed "financially hazardous." Four years later, Utah followed suit and adopted a similar formula that introduced additional factors for two broad categories of assets.

New York and Minnesota subsequently drafted more sophisticated formulas that incorporated risk categories developed in the 1970s by the Society of Actuaries' Committee on Valuation and Related Areas. These risk categories had been defined as follows: C-1, asset default; C-2, adverse insurance experience; C-3, interest rate fluctuations; and C-4, miscellaneous business risk.

The NAIC working group's charge to the industry advisory committee was to develop a risk-based capital formula based on the Minnesota and New York test formulas and to identify and address the technical issues inherent in applying a single risk-based capital formula to all life insurance companies. The purpose of the proposed risk-based capital formula is to help regulators distinguish companies that are weakly capitalized from those that are not and, on that basis, to take appropriate regulatory steps. The formula is not designed to distinguish the relative financial strength of strong companies; the advisory committee insists that the formula not be used as a measure for ranking or rating companies.

To determine a company's risk-based capital ratio, a company's "adjusted capital" is compared with the risk capital obtained from the risk-based capital formula. "Adjusted capital" is equal to capital and surplus plus mandatory securities valuation reserve (MSVR), voluntary

investment reserves, and half of the dividend liability. If adjusted capital is below the formula amount, the advisory committee recommends one of three levels of regulatory action, depending upon the extent of the deficiency. (The trigger points for these regulatory actions are yet to be determined.)

As a solvency measure, the life risk-based capital formula is expected to supplement the IRIS ratios and other regulatory screening tools already in place.

The committee decided that the formula should rely on statutory annual statement data as much as possible. The committee rejected alternatives such as using market values or setting a common minimum valuation standard for all companies. Insurer solvency is determined on the basis of statutory accounting standards, so the committee saw no reason to have risk-based capital requirements rest on anything else, or, in its words, to have the formula "compensate for real or perceived shortcomings or abuses of statutory accounting."

In the same vein, the committee decided to rely on the appointed actuary's opinion and supporting memorandum regarding reserves. The Standard Valuation Law now requires all but the smallest companies to have their appointed actuary conduct cash-flow or similar testing and consider C-1, C-2, and C-3 risks in opining on reserve adequacy. Therefore, in most cases, if the actuarial opinion reports that reserves in the aggregate are adequate, the risk-based capital requirement is simply the additional amount needed to absorb catastrophic losses or unusual variations in experience.

Significant parts of the formula, for example the C-1 factors for bonds and the C-2 mortality factors, were developed using stochastic modeling with consistent assumptions. Advisory committee chairperson Stephen Steinig commented that the modeling techniques are believed to be the most extensive and sophisticated ever used to develop a public formula.

The proposed formula adjusts for concentration and diversity of

The life risk-based capital formula was pretested on a database of 674 companies before its public release, December 8, 1991.

risks. For example, mortality, morbidity, and bond factors are keyed to the size of the company's exposure to each risk. The formula doubles the risk-based capital requirement for a company's ten largest asset exposures to reflect the asset concentration risk.

The risk-based capital requirements for C-1, C-2, and C-3 risks are combined in a way that adjusts for these risks' covariance. All such losses do not occur at the same time; some scenarios are mutually exclusive. Simply adding all the risk charges together overstates the company's total risk. To offset this effect, the proposed formula contains a "covariance adjustment."

Some data that the committee wanted to use in the formula were not available from the annual statement. For example, information on a company's ten largest assets, data required to assess a company's concentrated asset risk, is not currently reported in the annual statement.

The formula does not reflect liquidity risks, the vulnerability of a company to a "run on the bank," at least not directly. Certainly, less liquid assets, such as real estate and Schedule BA assets, have higher risk-based capital factors than many other assets for purpose of the formula. But, as the report notes, "liquidity risk is not the same as solvency risk." A fully liquid company can be insolvent and a very strong company may not be very liquid.

The advisory committee recommends that once the formula is adopted, it be subject to ongoing review. The committee believes that for the formula to be effective as an early warning signal, the formula must be regularly updated to reflect changes in the insurance industry, market, and regulatory environment.

Time Frame for Exposure

In submitting its report to the NAIC working group, the advisory committee recommended that the formula be tested more broadly in 1992, using 1990 and 1991 year-end data during an extended comment period, "to get wider input from companies, regulators, and other interested

parties that were not directly involved with the development of the formula." The advisory committee's executive committee will be working with the NAIC to evaluate comments and, if necessary, further modify the formula. The working group is aiming for adoption of a final formula at the December 1992 NAIC meeting.

Standard Nonforfeiture Law II Wants You!

by W. Keith Sloan

At the December meeting, the National Association of Insurance Commissioners (NAIC) exposed for comment the "Second Standard Nonforfeiture Law for Life Insurance" (SNFLII). The current draft, the eleventh in a series, is actually the second exposure draft and incorporates some additional "eleventh-hour" changes. As the Standard Nonforfeiture Law before it, it attempts to clarify various equity issues for life insurance products. However, given the changes just proposed, it seems to raise a broader issue: will actuarial equity be determined by actuaries or lawyers?

A new Section 16, titled "Equity Considerations," would authorize the state insurance commissioner to promulgate regulations "implementing rules relating to equity in nonforfeiture values, dividends and nonguaranteed elements."

The Standard Nonforfeiture Law always was based on the notion of at least partial equity among policyholders. But, in the past the model law has had a limited focus: the equity between policyholders who hold on to guaranteed benefits and those who cash them out. Because such a large portion of today's insurance is supported by dividends and other nonguaranteed elements, which are not uniform-

The Academy Committee on Life Insurance Financial Reporting expects to comment on the proposed formula and would welcome your input.

To obtain a copy of the life risk-based capital advisory committee's report, contact the Academy's Washington office and request document 91-L-4. ■

ly regulated by other laws, regulators thought that the Standard Nonforfeiture Law's focus should expand.

The intent of SNFLII "is to achieve a degree of equity between terminating and persisting policyholders of a particular policy form; and similarly to achieve a degree of equity among all classes of persisting policyholders who have the same form but use the policy in different ways." (Section 1)

Other new concepts included in the first exposure draft resulted in only a few comments. These concepts include the following:

—SNFLII includes an optional provision for adjusting cash surrender values—not paid-up or extended term benefits—for changes in the interest rate environment. Formulas for calculating the adjusted cash surrender value must be filed and approved, or, alternatively, a policy provision stating how a fixed charge would apply may be included in the policy. In either case, the policy must include a notice that such a provision is contained. A regulation is proposed, so as to provide details.

—The required provision for deferral of payment of cash surrender values is changed to require a company that chooses to exercise its right to do so on all policies containing the provision after first getting the commissioner's approval. If it does not, payment must be made within five business days after demand is made. If an adjusted cash surrender value is deferred, the amount to be paid is the greater of either the amount before deferral or the amount at the date of payment.

Continued on page 16

BEYOND FORECAST 2000

As the Forecast 2000 program enters year four, it is being supported by a new public relations firm, Stephen K. Cook & Company, replacing Edelman Public Relations Worldwide.

The primary target audience of the 1992 program, Beyond Forecast 2000, is public policy makers rather than the press. The program's advisory board once again chose four issues to focus on in 1992: Defined benefit plans, health-care reform, workers' compensation, and deposit insurance.

At the end of 1991, a request for proposals was circulated to several major public relations firms. Six firms expressed interest in the request, and five eventually submitted proposals. Of those five, two made presentations to Academy staff, and Cook & Company was chosen in December to represent the actuarial profession in North America in 1992.

Beyond Forecast 2000 is cosponsored by the American Academy of Actuaries, the American Society of Pension Actuaries, the Canadian Institute of Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries.

NAIC Report

by Gary D. Simms

In one of the most active sessions in recent memory, the National Association of Insurance Commissioners (NAIC) adopted several major new model laws and regulations, and approved exposure of many additional proposals for comment. The meeting, held in Houston from December 8 through 12, was highlighted by activity in the life, health, and property/casualty areas.

Life Insurance Issues

The NAIC's Life and Health Actuarial (Technical) Task Force, chaired by John Montgomery of the California Insurance Department, began its two days of deliberations before the official NAIC meeting began. The task force reported its recommendations through the NAIC subcommittee and committee structure, and the following major initiatives were approved:

—The model Standard Valuation Law, adopted in 1990, was amended to clarify the intent of Section 3 of the model. As revised, the model law requires that an actuarial memorandum is required only when an opinion is required by the law. A minor change to the model Actuarial Opinion and Memorandum Regulation was also adopted, and makes provision for a commissioner to determine that the first or second priority status of a company has been resolved to the commissioner's satisfaction, for purposes of the exemption eligibility tests. The amendment also requires the commissioner to notify the NAIC Life and Health Actuarial Task Force and the NAIC central office in the event such a determination is made.

—A proposed actuarial guideline titled "Guideline for the Application of Plan Type to Guaranteed Investment Contracts (GICs)" was approved for exposure. The guideline specifies two conditions under which a GIC would be classified other

than a Plan Type C annuity for purposes of the application of the Standard Valuation Law. The test of Guideline AAA is as follows:

For purposes of the application of the Standard Valuation Law to Guaranteed Investment Contracts (GICs) with benefit responsive provisions, the withdrawal of funds at book value for the purpose of redirecting an employee investment shall be considered a withdrawal by the policyholder unless the underlying plan or GIC contain written provisions that are designed to reduce the C-3 risk to the insurance company. Provisions that meet this criterion would include the following:

—No direct transfer to competing funds. This provision prohibits direct transfer of funds from the GIC option to a competing plan option that offers a guarantee of principal. Any transfer out of the GIC option must first go through an equity option and reside there for at least ninety days or three months.

—The plan participants cannot select the redirection of funds from specified GICs crediting different interest rates to distinct contributed amounts.

In addition, the valuation actuary must be satisfied that the plan provisions designed to reduce the C-3 risk are being administered in the designed manner.

Risk-Based Capital Formula. The Life Risk Based Capital Working Group's proposal to begin testing its approach in 1992 was approved by the Examination Oversight (EX4) Task Force. The extensive testing of the risk-based capital formula for life insurance companies will take place throughout 1992. Under the formula, a threshold of risk based capital will be calculated; a failure to maintain this level will trigger regulatory activity. The risk factors cover all risks, both related to assets and to liabilities. The formula is intended to encourage a higher level of capital for companies with investment portfolios of greater risk, and higher capital for companies offering riskier products. (See story on page 4.)

Valuation of Securities. The Valuation of Securities (EX4) Task Force approved the replacement of the Mandatory Securities Valuation Reserve (MSVR) with the new Interest Maintenance Reserve (IMR)/Asset Valuation Reserve (AVR) combination. MSVR will continue to be reported for the first three quarters of 1992, but the IMR/AVR will be used for the fourth quarter and the 1992 statement. The IMR captures all interest-related realized capital gains and losses as they occur. It is not subject to any maximum or minimum, but negative values require an actuarial opinion stating that the policy and claim reserves reduced by the negative IMR make adequate provision for the liabilities. The AVR captures all credit-related recognized capital gains and losses. In addition, an annual contribution is made to each subcomponent equal to 20% of the excess of (a) the maximum balance for the subcomponent over (b) the current accumulated balance in each subcomponent. The maximum balance for each subcomponent remains an open issue to be studied in coordination with efforts of the Risk-Based Capital Working Group.

—The NAIC agreed to expose for comment a revised model nonforfeiture law titled "Second Standard Nonforfeiture Law for Life Insurance." (See story on page 5.) The Life and Health Actuarial Task Force indicated a desire to see its adoption at the June 1992 meeting.

A previous draft of this proposed model law was exposed for comment in June 1991. Both the previous and the current drafts would apply only to new life insurance policies that are issued after some specific future date. One important difference between the June 1991 and the current draft is that the current draft does not contain a detailed provision on enhancements. The current strategy is to develop a companion NAIC model regulation on enhancements.

—The Life Insurance Committee approved adoption of a new Two-Tier Annuity Model Regulation and the Two-Tier Annuity Disclosure Form. The

The NAIC agreed to expose for comment a revised model nonforfeiture law titled "Second Standard Nonforfeiture Law for Life Insurance."

model covers annuities that have different values depending upon whether, at maturity, the value is taken from the contract as a lump sum or left with the insurer for periodic payment. The models are intended to enhance informed choice by consumers.

—The NAIC will expose for comment the report of the Actuarial Advisory Committee on the Revision of Annuity Nonforfeiture Law. The advisory committee report addresses single premium deferred annuities (SPDA) and flexible premium retirement annuities (FPRA) that provide cash values. The report does not address the features specific to variable rate annuities or modified guaranteed annuities. The report includes proposed rules for both SPDA and FPRA nonforfeiture values. In addition, it includes conclusions and recommendations on the treatment of fixed dollar fees, no-cash-value annuities, CD annuities, and annuities with nongraded nonforfeiture values.

Property/Casualty Issues

The Casualty Actuarial (Technical) Task Force, the Blanks (EX4) Task Force, and the Financial Condition (EX4) Subcommittee played an intricate game of move and countermove in a variety of actions, some of which will affect the 1991 annual statement.

—Three changes to the 1991 annual statement were adopted by the Blanks Task Force under a unanimous consent arrangement, dispensing with the normal methods for consideration of change. These three revisions are effective for the 1991 loss reserve opinion:

Any reference to audited data in Section 10 of the Annual Statement Instruction 12 has been deleted. Thus, the June 1991 action that would have required reliance on audited data has been rescinded for 1991 opinions. Members of the Blanks Task Force agreed that the requirement would cause timing problems and that it would be better to have a group of representatives from the Academy, NAIC, and the American Institute of Certified Public Accountants draft language addressing the issue of

data integrity for adoption for the 1992 opinion.

The amount of salvage and subrogation recoverable used to reduce loss reserves is to be disclosed in the 1991 opinion and subsequent opinions. A new Note #17 to the financial statements will require companies that report reserves net of anticipated salvage and subrogation to disclose the amount by line of business. This total is also to appear in the 1991 loss reserve opinion. However, it should be noted that the Blanks Task Force expects to allow latitude in cases where there is difficulty obtaining this information from pools, associations, or reinsurance cedents. Finally, a study group was formed to review whether the annual statement instructions should be revised to require reporting reserves net of anticipated salvage and subrogation.

The amount of discount for the time value of money used to reduce loss reserves (other than the tabular workers' compensation discount) is to be disclosed in the 1991 opinion and subsequent opinions. Note #16 to the financial statements is amended by adding: Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expense Other than Statutory Discounting of Workers' Compensation Tabular Reserves. If the company is required to respond to this note in the affirmative, it must also respond in the affirmative to Schedule P Interrogatory #5 and complete columns #30 and #31 of Part 1, Part 1a, etc., of Schedule P. Finally, the amount of discount for the time value of money is to appear in the 1991 loss reserve opinion.

—The Casualty Actuarial (Technical) Task Force, chaired by Michael Lamb of Oregon, completed work on proposed language for the establishment of a reserve for retirement coverage under claims-made professional liability contracts. The Accounting Practice and Procedures (EX4) Task Force had asked the Casualty Actuarial Task Force to develop appropriate language; having done so, the task force referred the matter back to the accounting group for action.

—The Property and Liability Risk-Based Capital Working Group reported to the Examination Oversight (EX4) Task Force on its activities, and its chairman stated that the group was seeking to develop uniform levels of capital for insurers. The requirements are being formulated in recognition of the fact that current fixed-dollar minimum capital requirements are archaic. Testing on the preliminary formulas will be done privately. Many areas are still in need of attention, including the determination of an appropriate discount rate for reinsurers, how to address small companies and rapidly growing companies in the formulas, and relative asset factors. The working group plans to present a formula in June 1992, together with appropriate implementing regulations.

—The Statistical (D) Task Force reported that the Closed Claims Information Working Group was in the process of finalizing its first study, which should be available in early January. In the report to the Commercial Lines-Property and Casualty Insurance (D) Committee, the working group noted it had also begun work on the second closed-claim study. The group envisions that closed-claims studies would be conducted every two years.

Health Insurance

Action related to long-term care, small employers' access to health insurance, and a new proposed rate filing guideline were the centerpieces of action in the health area at the Houston meeting.

The Long-Term Care Insurance (B) Task Force adopted a number of amendments to the Long-Term Care Insurance Model Regulation. The amendments included the following changes:

Prohibition of attained age rating and durational rating. A new subsection G to Section 6 of the regulation reads as follows:

"G. The premiums charged to an insured for long-term care insurance shall not increase due to either (1) the increasing age of the insured at ages beyond 65; or

Continued overleaf

Any reference to audited data in Section 10 of the Annual Statement Instruction 12 has been deleted. Thus, the June 1991 action that would have required reliance on audited data has been rescinded for 1991 opinions.

EDITORS' INVITATION TO READERS

**The Update
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Jeanne Casey
at the
Academy's
Washington
office.**

(2) the duration the insured has been covered under the policy."

New minimum standards for home-health and community care. Specifically, if offered, the home-health-care component of a long-term care policy must be of a certain minimum level. Subsection B of Section 9 of the long-term care insurance model regulation permits home-health-care and community-care benefits to be counted toward the maximum length of long-term-care coverage under the policy but specifies a minimum level of coverage. In addition, a drafting note suggests that fewer than 365 benefit days and less than a \$25 daily maximum benefit constitute illusory home-health-care benefits.

Changes to the inflation protection provisions. Changes to Section 10 (including new subsections E, F and G) require, among other things, offering inflation protection and continuing inflation protection without regard to an insured's age, claim status or claim history, or the length of time the person has been insured under the policy.

In addition, the Long-Term Care Insurance Task Force agreed to expose for comment new trigger requirements linked to inability to perform two of five activities of daily living (ADLs) and impairment of cognitive ability. In addition, out for comment is a set of requirements dealing with inflation protection for consumers, and another proposal related to nonforfeiture benefits under such policies.

The NAIC adopted the "Small Employer Health Insurance Availability Model Act" that seeks to guarantee health insurance coverage to employees of small businesses. The NAIC endorsed two versions of the model law. One is based on a reinsurance concept; the other, on an assigned risk concept prevalent in property/casualty insurance.

The NAIC model law would require insurers to cover all eligible employees and dependents of a group, would require an insurer replacing group coverage to insure all employees and dependents that were insured previously, and would prohibit insurers from requiring new waiting per-

iods for preexisting conditions when groups change carriers or when insured individuals change employers.

The Life and Health Actuarial (Technical) Task Force will expose a revised draft titled "Guidelines for Filing of Premium Rates for Individual Accident and Health Insurance Contracts." Recognizing that the document in current form is "far from a complete or refined document," the actuarial task force recommended exposure for comments at this juncture, with review in March. Small-group concerns remain a major focus of the doc-

The NAIC adopted the "Small Employer Health Insurance Availability Model Act" that seeks to guarantee health insurance coverage to employees of small businesses.

ument. The task force seeks its adoption in June, 1992. The proposed guidelines include a pre-filed option and a more detailed delineation of the annual review of experience requirements. Rating variations by policy form are to be controlled through a closed block/open block maximum variation, together with credibility standards. Controls on the future rates to be charged to policyholders would be accomplished through rate-increase caps, new loss ratio standards, and limitations on renewal compensation.

The Life and Health Actuarial (Technical) Task Force also sought and received approval for the adoption of a new guideline, "Statutory Claim Reserves for Group Long-Term Disability Contracts With a Survivor Income Benefit Provision." The guideline was approved by the Accident and Health (B) Committee. The guideline states in part that a "suitable approximation of the sum of the reserves for the basic disability benefit and the reserve for the survivor bene-

fit can be calculated by computing the reserves for the basic disability reserve at an interest rate less than the maximum valuation interest rate."

Other NAIC News

—The NAIC/AAA/ASB Joint Committee on Standards and Related Items met and discussed issues related to discipline, whether laws relating to actuarial consideration should be part of the NAIC's program of state accreditation, and standards of practice in the life, health, and property/casualty areas.

—The NAIC elected its new officers for 1992, selecting William H. McCartney, Nebraska's Director of Insurance, as its president. Elected vice president was Stephen T. Foster, commissioner of insurance of Virginia. David Walsh, director of the Alaska Division of Insurance, was elected secretary.

—In a major break with the traditional warm gubernatorial greetings usually seen at NAIC conclaves, Texas Governor Ann W. Richards blasted insurance companies for unfair legal tactics and for a lack of help in the legislative process, recognizing that "insurance long ago has become a necessity and not a luxury." The governor also had less than kind words for insurance regulators, who labor in what she called "comfortable and cozy bureaucracies."

—The NAIC approved the requests of five additional insurance departments for accreditation, bringing the total to nine that have demonstrated compliance with the NAIC financial regulation standards. Approved in December were Iowa, Kansas, North Carolina, Ohio and Wisconsin, joining the four previously approved states of Florida, Illinois, New York, and South Carolina.

—The Annual Robert Dineen Award for outstanding service by an insurance department staff member was presented to Assistant Deputy Superintendent and Chief Examiner Terrence Lenn of New York.

Simms is former general counsel for the Academy.

actuary has solid standards and can inspire confidence, everyone is better off and ultimately happier." Shapiro notes that the scope of the standard applies to "facilitating the financial management of an insurance company" and "determining the value of insurance companies, insurance marketing organizations, or blocks of insurance contracts for tax purposes," as well as to mergers and acquisitions of companies or parts of companies.

Patricia L. Guinn, manager of the life consulting actuarial group in the New York office of Tillinghast/Towers Perrin, says that with respect to M&A and management valuations, Actuarial Standard No. 19 does "put up a wall beyond which the actuary cannot go. So the actuary can be the nice guy, and the standard can be the bad guy. The standard will help the actuary take a stand, if the actuary couldn't take a stand before." Guinn, a member of the drafting task force, had argued for strengthening the standard on specific points such as recognition of capital needs and use of stochastic methods. But her overall impression is that "the exchange of ideas among the members was very valuable, and the end result is something I am proud to be associated with."

Competing philosophies that contributed to a credibility gap in actuarial appraisals could have been expected to surface in the task force's deliberations, and they did, chairperson Shapiro says, in such areas as the definition of earnings, the treatment of required surplus, and taxation. The end result of more than two years of meetings and two exposure drafts was a compromise approved without dissent by the task force and the ASB. "The standard isn't perfect," opines Shapiro, "but given the different viewpoints represented by top consultants with different perspectives, it is an accomplishment."

Another set of outstanding issues addressed in the development of the standard were the

differences between life/health and property/casualty disciplines. "It was not easy for the life actuaries, and harder still for the P/C actuaries [on the task force] to bridge the gaps," recalls Allan M. Kaufman, P/C consulting actuary at Milliman & Robertson in New York and one of the most active members of the drafting group. Development of the standard "forced us to create a framework for more uniformity across disciplines," he says. And since appraisal users are generally not specialized by line of business, the standard "helps the users—investment bankers, for example—to see the why of actuarial work and makes it easier for us to explain the differences between disciplines."

One example of these differences is in the treatment of required capital. "P/C buyers and sellers have had an understanding about capital needs—the rule of thumb was something like \$2 or \$3 of premium to \$1 of surplus, but, especially before 'risk-based capital,' there were no similar rules on the life side," according to Kaufman. After lengthy discussions, the standard came out prescribing that "the actuary should disclose the manner in which capital needs were considered" and adding that the actuary "may include an estimate of the cost of such capital."

Another interdisciplinary difference was in the degree of detail prescribed in the treatment of expense assumptions, for example. Because expenses are not normally a critical issue in P/C appraisals, task force members got language inserted to make clear that long-term business, more than short-term, was the main concern in this subsection.

Overall, Kaufman thinks the standard "won't make a change in accepted P/C appraisal practice," but "will focus actuaries' attention on what most needs doing in an appraisal." Also, actuarial studies prepared for information purposes that may resemble appraisals but do not meet the standard's definition of an appraisal must now be called

something else. And Kaufman likes another of the standard's disclosure requirements—that assumptions be characterized as to their level of reasonableness and consistency with past experience. This "won't eliminate differences in appraisal value, it will explain to the user what generated the differences."

The genesis of the standard was a request from the ASB, made by the board's then vice chairperson, now chairperson, Jack M. Turnquist, a veteran of actuarial appraisal work. Turnquist recalls that "some abuses had been observed," and "actuarial credibility may have suffered as a result." The ASB asked Harold G. Ingraham, Jr., and Michael J. Miller, chairpersons respectively of the board's Life and Casualty Operating Committees, to form a task force. In addition to Shapiro, Guinn, Kaufman, and Galban, they chose life actuaries Robert L. Beisenherz, Robert L. Collett, Charles Carroll, and Gary N. See; casualty actuaries James A. Hall III, and Stephen P. Lowe, and investment banker Reuben Jeffrey III.

The standard became effective on January 10 for actuarial appraisal reports dated on or after that date.

Kennedy is standards editor for the Actuarial Standards Board.

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SFAS 106 Guideline

Some actuaries report they did not receive a copy of the proposed actuarial compliance guideline on accounting for postretirement health-care benefits, which was mailed with December's *Update*. Others did receive it. Readers should request the booklet from the ASB at 1720 I Street NW, 7th Floor, Washington, DC 20006, (202) 223-8196. The deadline for written comments on the draft is March 15.

Annual Committee Reports

Casualty Committees

Committee on Property and Liability Issues

The committee prepared numerous statements and testimony including:

- Oral and written testimony in California on proposed rules for implementing Proposition 103. The testimony pointed out departures from actuarial ratemaking principles and why such departures are almost certain to increase the cost of both government administration and the overall insurance system.

- A statement that discussed causes of the personal automobile insurance crisis and proposals for reducing costs.

- A white paper on auto insurance for the actuarial profession's Forecast 2000 campaign.

In addition, studies are underway on workers' compensation, McCarran-Ferguson, and profitability measures of the National Association of Insurance Commissioners (NAIC).

Robert V. Deutsch
chairperson

Committee on Property and Liability Financial Reporting

The major activities focused on the NAIC's requirement for the actuarial opinion on casualty loss reserves. Efforts in this area included:

- Correspondence and meetings with members of the NAIC Casualty Actuarial Task Force. The task force adopted the appointed actuary concept that the committee recommended as did the full NAIC.

- Discussions with the NAIC on the relationship of the audit completion date of June 1 and the statement of actuarial opinion date of March 1.

- A survey of regulators on 1988-90 insolvencies to help determine the effectiveness of casualty loss reserve opinions. Preliminary evidence shows that the largest number of insolvencies did not have an opinion signed by a qualified actuary.

- An analysis of reasons for highly adverse development in situations where companies with large loss reserves had received clean opinions before the adverse

development. This analysis is part of a larger effort to develop a proposal for the Actuarial Standards Board (ASB) on standardized wording for opinions in exceptional situations.

Additional committee activities included:

- Preparing a statement to and testifying before the Financial Accounting Standards Board (FASB) on its discussion memorandum, "Present Value-Based Measurements in Accounting." One of the committee's major points was that using present value-based measurements is possible so long as the interest rate is risk-adjusted.

- Following the NAIC's progress in developing property-casualty risk-based capital requirements.

- Monitoring developments in the American Institute of Certified Public Accountants (AICPA) and the Canadian Institute of Chartered Accountants and accountants' and actuaries' reliance on one another.

- Working with the AICPA to include proper references to the role of the actuary in AICPA exposure draft on auditing insurance entities' loss reserves.

David G. Hartman
chairperson

Health Committees

Committee on Health

Committee activities focused on reform of the small-group market, the uninsured, and the need for and potential cost of long-term care. Specific projects included:

- An article for *Contingencies* (July/August 1990) titled "Can We Afford Public Funding for Long-Term Care?"

- A white paper on the potential long-run cost of a public program designed to finance long-term care.

- Testimony before the House

Energy and Commerce Subcommittee on Commerce, Consumer Protection, and Competitiveness for hearings on "The Rising Cost of Private Health Insurance: The Rating System."

- Testimony before the House Ways and Means Subcommittee on Health regarding improving access and the affordability of health insurance for small groups.

- A short statement prepared at the request of members of the Subcommittee on Health concerning the impact of community rating on premiums for small groups.

- A discussion of the probable impact of H.R. 1565 (Health Equity and Access Reform Act of 1991) at the request of Representative Nancy Johnson, one of the bill's cosponsors.

In addition, committee representatives met with congressional staff to discuss various aspects of small-group health insurance reform.

Edward J. Wojcik
chairperson

Committee on Health and Welfare Plans

The committee focused on a broad set of issues ranging from problems facing multiple employer welfare arrangements (MEWAs), to qualifications for health actuaries, the development of a credible health database, tax policy, and accounting for retiree health bene-

fits. Specific projects included:

- Working with interested private-sector parties in finding ways to allow self-insured MEWAs to exist while safeguarding the financial security of participants.

- Commenting on proposed MEWA legislation both before and after its introduction in Congress. (Recent MEWA failures have led to an understanding by outsiders of the important role actuaries can play in maintaining financially sound MEWAs.)

- Developing preliminary qualification standards for health actuaries, an issue that arose in the context of Internal Revenue Code Section 419 and Statement of Financial Accounting Standards (SFAS) No. 106, the accounting standard for postretirement benefits that was issued in December 1990 and reflects many of the committee's comments to FASB.

- Working with the Academy Committee on Qualifications to find the correct method for disseminating information on qualifications for specific types of health actuarial work.

- Discussing the need for and possible development of a credible, widely available health database. Further action was tabled pending the outcome of activities underway in the Society of Actuaries (SOA) Health Section.

- Meeting with congressional staff on legislation that would make advance funding of retiree health benefits more attractive.

- Continued monitoring and discussion with FASB staff on SFAS 106.

- Preparing to comment on the new AICPA statement of position on accounting and reporting by health and welfare plans.

- Submitting comments to the House Ways and Means Subcommittee on Health regarding H.R. 3205, a bill that would seek to reduce employers' retiree health liabilities by lowering the Medicare eligibility age to sixty.

Jeffrey P. Petertil
chairperson

Committee on State Health Issues

The committee continued to provide technical support and to develop proposals for the NAIC Life and Health Actuarial Task Force and working groups closely associated with the task force's projects. In the area of health ratemaking, the committee provided the task force with:

- A report on issues concerning the proposed rate-filing guidelines, guidelines the committee had initially drafted.

- Comments on proposed changes to the model rate regulation.

- A suggested form for requesting data on major medical expenses from insurers, information that could be used in determining appropriate loss ratios for the new health rate-filing guidelines.

The committee also worked with a subgroup of the task force on a new model law for Medicare Supplemental (MedSupp) policies that was required by the Omnibus Budget Reconciliation Act of 1990 (OBRA 90). The committee:

- Submitted a report to Larry Gorski (Illinois Department of Insurance) enumerating issues related to OBRA 90, including loss ratios, uniform reporting, and refund-of-premium methodology.

- Provided information on MedSupp loss-ratio compliance to assist in the development of standards required by OBRA 90.

- Submitted comments on the calculation of refunds using nationwide experience.

- Drafted a new Section 11 on loss-ratio standards and refund of premium to be included in the revised NAIC Medicare Supplemental Model Law.

- Commented on the exposure draft of the Medicare Supplemental Model Law.

The committee also assisted the NAIC by providing:

- Comments on a proposal to allow the use of lapse rates in setting policy reserves for return-of-premium or cash-value policies.

- Comments to the NAIC Health-Care Insurance Access

Working Group on its interim report.

- Data on experience by duration on group major medical conversions obtained from three companies. The report was forwarded to NAIC Actuary Mark Peavy.

Finally, the committee began to monitor state health insurance reform initiatives, especially in the small-group area. The committee, most probably in conjunction with the Academy's other health committees, anticipates greater involvement in this area over the next year.

William J. Bugg, Jr.
chairperson

Committee on Continuing Care Retirement Communities

In 1990-91, the committee continued work on six major initiatives:

- Revising Actuarial Standard of Practice No. 3 on Continuing Care Retirement Communities (CCRCs). The revision should be completed during the first quarter of 1992.

- Working with the NAIC's CCRC task force on the development of model NAIC regulations.

- Working with various state regulators in designing and drafting individual state regulations.

- Working with legislators and other interested parties on proposed legislation by undertaking projects in Florida, Maryland, and New York.

- Reviewing the financial aspects of CCRCs seeking to gain or renew their accreditation with the American Association of Homes for the Aging and work with the association in developing financial standards for CCRC accreditation.

- Gaining broader acceptance for actuaries and actuarial techniques in the area of CCRC solvency.

Harold L. Barney
chairperson

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Annual Committee Reports

Committee on Risk Classification

The committee expanded its educational efforts using the risk-classification slide show developed in 1989 by:

- Developing a number of case studies to illustrate points made in the slide presentation.

- Preparing questions and answers to be used as training material for an expanded group of presenters.

- Conducting training sessions on both the East Coast and

the West Coast for actuaries interested in presenting the slide show on behalf of the committee. More than a dozen new presenters were trained.

In addition, the committee commented on the Equal Employment Opportunity Commission's (EEOC) proposed rules for implementing the Americans with Disabilities Act of 1990. The response focused on four questions the EEOC raised on the effects of risk classification on insurance costs.

Jean M. Wodarczyk
chairperson

ASB proposed standards relating to actuarial appraisals and the cost of HIV-related claims.

Paul F. Kolkman
chairperson

Joint Committee on the Valuation Actuary

Over the past several years the committee has worked with the NAIC to develop a more meaningful role for the actuaries who do valuations for life insurance companies. This effort has resulted in:

- Adoption of changes to the NAIC Standard Valuation Law in 1990 that embraced the concept of the appointed actuary, who is now required to opine on the adequacy of reserves reported by a life insurer in light of its assumed risks and asset mix.

- Adoption in 1991 of an NAIC model regulation to complement the change in the Standard Valuation Law.

- A requirement that the Standard Valuation Law changes be adopted by states in order to become NAIC-accredited.

Having fulfilled its objectives, the joint committee was discharged. The Academy's Life Practice Council and appropriate committees will handle any future work related to the appointed actuary.

Walter S. Rugland
chairperson

Life Committees

Committee on Life Insurance

The committee continued to work closely with the NAIC Life and Health Actuarial Task Force in two key areas, sales illustrations and the annuity valuation law. Specific activities for the task force included:

- Developing and running smoothness tests for sales illustrations for the task force's consideration. The objective is to determine whether reasonable tests can be developed to detect potentially manipulative illustrations.

- Examining the interrogatories on the NAIC blanks and the related actuarial standards. The current interrogatories on nonguaranteed elements and dividends are vague and open, which often leads to answers that provide little useful information. The committee will propose changes and report to the NAIC task force and the ASB.

- Considered options for improving the understanding and uniform interpretation of the actuarial standards on dividend and nonguaranteed element determination. One option under consideration is an ethics course for actuaries responsible for answering statement interrogatories.

- Preparation of a paper on

all known outstanding Commissioners Annuity Reserve Valuation Method (CARVM) issues. A draft report was sent to the NAIC task force with a final reported planned for March 1992.

- Organizing a 1992 valuation actuary seminar for state regulators.

Written reports on the committee's work on illustrations, interrogatories, and CARVM issues will be available in early March 1992.

Philip K. Polkinghorn
chairperson

Committee on Life Insurance Financial Reporting

The committee's efforts focused on activities of the Financial Accounting Standards Board (FASB) and the ASB. The committee:

- Succeeded in urging FASB to consider the consistency of the accounting on both sides of the balance sheet as FASB continued its deliberations on accounting for debt securities, including requiring such securities to be reported at market values.

- Reviewed and responded to FASB's discussion memorandum, "Present Value-Based Measurements in Accounting."

- Reformatted the Academy's life insurance financial reporting recommendations and interpretations as standards of practice.

- Reviewed and responded to

Pension Committees

Pension Committee

The committee continued to focus on proposed Internal Revenue Service (IRS) regulations on nondiscrimination and Congress's consideration of simplified rules for qualified pension plans. Specific projects included:

- Testimony before the IRS on proposed 401(a)(4) nondiscrimination regulations.

—Joint testimony with the American Society of Pension Actuaries (ASPA) on proposed IRS regulations on separate lines of business.

—Development of an initial set of qualified-plan tax-simplification proposals.

In addition, the committee:

—Testified before the ASB regarding benefits upon involuntary termination of an employee group.

—Prepared suggestions for the Academy's Committee on Qualifications concerning educational requirements for public-plan actuaries.

—Considered various options for establishing a pension actuaries' electronic bulletin board. The committee expects to make a recommendation to the actuarial organizations during 1992.

John B. Thompson
chairperson

some outside standard is available. The committee has encouraged GASB to adopt the ASB standard on selection of economic assumptions for pension plans if the ASB standard is available in time.

—To respond to pension benefit questions from states that have been generated by the proposed GASB standard.

Darrel J. Croot
chairperson

Committee on Social Insurance

In the past, the committee has focused on the Old Age, Survivors, and Disability Insurance (OASDI) program under Social Security. This year the committee broadened its focus. Specific projects included:

—Reviewing the reports of the three technical panels appointed by the Social Security Advisory

Council. Committee Chairperson Steve Kellison served on all three panels.

—Developing and disseminating among policy makers a major statement on measuring and disclosing the financial condition of the Supplementary Medical Insurance (SMI) program (i.e., Meeting with the government actuary who works on unemployment insurance at the federal level and discussing the past actuarial involvement (or lack thereof) in unemployment insurance and what role, if any, actuaries should play in this area in the future.

—Developing a proposed ASB standard on social insurance and presenting it at the ASB's October meeting.

—Maintaining ongoing liaison with the SOA Committee on Social Insurance, including commenting on the SOA committee's development of a professional actuarial specialty guide.

Stephen G. Kellison
chairperson

Committee on Pension Accounting

The committee continued to focus on the Government Accounting Standards Board's (GASB) proposed "Statement on Accounting for Pensions by State and Local Government Employers." This statement will be the public-employer plans' counterpart to FASB Statement of Financial Accounting Standards No. 87. The committee worked with GASB:

—To develop appropriate standards within the wide range of current funding practices. (A GASB objective is to permit public employers to account for actual contributions to fund benefits if funding is based on an acceptable actuarial cost method designed to fully fund accrued benefits over a reasonable period.

—To develop language that will be interpreted on a consistent basis among actuaries, accountants, and other users of financial statements.

—To develop a position on appropriate actuarial assumptions. GASB wants to avoid defining explicit assumptions if

Professional and Administrative Committees

Budget and Finance Committee

During the past year, the committee monitored the Academy's financial position. In particular, the net costs of *Contingencies*, the Actuarial Standards Board, and the expanded government relations program were reviewed.

The committee also:

—Considered the results of the Academy's annual audit and reported them to the Academy Board of Directors.

—Made financial projections for the 1991-92 Academy year.

—Recommended to the board, on the basis of the projections, a tentative budget and the dues level for 1991-92.

—Continued to oversee the Academy's investment program and the administration of the Academy's dues waiver rules.

Thomas D. Levy
treasurer

Committee on Qualifications

The committee reviewed comments received on the exposure "Revisions to Qualification Standards," which had been approved by the Academy's Executive Committee in July, 1990 and implemented on an interim basis. The final "Revisions to Qualification Standards" was presented to and adopted by the Academy Board of Directors on January 24, 1991.

In addition, the committee:

—Resumed work on a proposed specific-qualification standard for health statements of actuarial opinion and then con-

Continued overleaf

Annual Committee Reports

cluded that the development of such a specific qualification standard would inhibit flexibility and freedom of movement in the rapidly evolving health practice area.

—Decided to issue informal advisory memoranda to raise the consciousness of Academy members with respect to their professional obligation and ethical responsibility to be qualified in their area of practice.

—Drafted advisory memoranda relating to actuarial opinions under the account limit for health benefits under Internal Revenue Code Section 419 and under accounting standards issued by FASB and GASB.

In the coming year, the committee will continue to develop advisory memoranda to provide guidance to members in determining whether they are qualified to render various public statements of actuarial opinion. For example, the committee will explore with representatives from the pension practice area whether appropriate specific qualification standards can be developed for actuaries of public-sector plans.

John K. Booth
chairperson

Committee on Publications

Contingencies continued to garner awards for design, editorial, and general excellence. In only its second year of publication, *Contingencies* received the award for general excellence from the Society of National Association Publications (SNAP), competing against much larger associations whose publications had been in production for years. The judges praised the November/December 1990 *Contingencies* for its "effective use of illustrations and graphics; inviting writing style; good leads; [and] timely articles." The SNAP award is the third major award the magazine has received since beginning publication with the May/June 1989 issue. *Contingencies* also won a 1991 Silver

Inkwell for excellence in four-color magazine writing and design.

The magazine continues to earn enough advertising revenue to cover the majority of production costs.

Silvio Ingui retired as editor of the *Enrolled Actuaries Report* after a long and distinguished tenure. He was replaced by Richard G. Schreitmüller.

The results of the readership survey for *The Actuarial Update* were evaluated. Since the profession expressed satisfaction with the newsletter, no major changes in editorial policy are planned. Nevertheless, *The Actuarial Update* will be given a new look during the coming year to make its design more appealing and attractive.

Roland E. King
chairperson

Task Force on Actuarial Public Service

In 1990-91 the task force continued to consider what could be done to increase the number of qualified actuaries working in public service at the federal and state levels.

At the federal level, the task force:

—Supported efforts by the Chief Actuaries in Federal Service Coordinating Group (CAF-SCOG) to enhance the status and compensation of actuaries in federal service. Recent changes in compensation and related programs for federal employees, such as the Pay Reform Act of 1990, have significantly lessened compensation as a barrier to the consideration of federal employment by actuaries at the senior level. At the entry level, thanks largely to the efforts of CAF-SCOG, a special pay scale has been adopted that is competitive with the private sector. CAF-SCOG is now pursuing a similar special pay scale for mid-level actuaries in federal service.

—Ran a survey with the assistance of the NAIC central office in 1990, which indicates that the understaffing of state insurance

departments by qualified actuaries is the result of inadequate compensation levels relative to the private sector. It is not clear what can be done to alleviate this problem in the short run because of the pressures on state budgets generally.

The financial problems of the insurance industry at present would appear to offer an opportunity to highlight the importance of having state insurance departments adequately staffed with qualified actuaries to regulate insurance company solvency.

—Encouraged the editors of the various professional actuarial publications to run occasional articles that portray the role of actuaries in public service.

At the state level, the task force conducted a survey with assistance of the NAIC, which indicated that understaffing of actuaries in state insurance offices is severe. It is not clear what can be done to alleviate this problem because of pressures on state budgets generally.

Dwight K. Bartlett
chairperson

Committee on Professional Responsibility

The Committee on Professional Responsibility is charged with "the promotion and encouragement of knowledge within the profession regarding standards of conduct, qualification and practice, and suggesting ways and means for enforcement, compliance and monitoring of the effectiveness of those standards."

The committee met five times in 1991 in order to develop a report to the Academy Board of Directors. The committee:

—Recommended that, as an initial step, each member of the Academy would be asked annually to affirm his or her familiarity and compliance with the Academy's professional guidelines and qualification standards. This procedure is currently used by the Chartered Financial Analysts. The committee is seeking more information on the success

of that program and is also investigating the administrative requirements.

—Discussed the public relations challenge presented by the recent failure/takeover of several large insurers. The committee concluded that the actuarial profession needs to provide its members with some analysis and explanation of these failures, or risk seriously weakening efforts to promote professional responsibility.

—Suggested establishing a board of inquiry to investigate recent insolvencies, explain what transpired, and then recommend appropriate changes in guides, standards, or responsibilities. This effort should not be confused with the counseling and discipline process, which will no doubt proceed appropriately, in a confidential manner. Such an inquiry might well result in support for actuaries who have properly discharged their professional responsibility but whose clients or employers have nonetheless gotten into difficulty. While our committee's focus is primarily on our own members, it observes that an inquiry might also be helpful to regulators and legislators, clients and employers, and the public at large.

W. James MacGinnitie
chairperson

Committee on International Issues

The committee was created in 1990 as a result of recommendations from the Academy's Task Force on International Issues, on which many of the current committee members served.

During 1991, the committee had a conference call to discuss whether the committee had a distinct role in view of the fact that there are committees covering international issues or relations within the Society of Actuaries (SOA) and the Casualty Actuarial Society (CAS). Considering that the SOA and the CAS both handle education and examination and the Academy handles qualifications and stan-

dards, we thought that our continuance as an Academy committee was warranted.

In addition, the committee:

—Addressed the Academy's role in helping other countries set qualifications and standards of practice. This discussion was precipitated by a request from Taiwan for assistance in these areas. Before responding formally, the committee thought it should first determine under what circumstances actuaries with non-U.S. qualifications might be accredited to practice in the United States. This will be a joint effort with the SOA and CAS. The committee asked the Academy's general counsel and the ASB to respond to Taiwan's request in the interim.

—Worked on a background paper discussing procedures by which non-U.S. actuaries might be accredited to practice in the United States. The committee plans to focus on this project in 1991-92.

—Discussed the Institute of Actuaries' (United Kingdom) proposal for the initial training of actuaries; concluded that the SOA and CAS were the proper bodies to respond in detail; however, wrote a letter to the Institute voicing support.

—Discussed the need to recruit a vice chair and a few additional members.

Margaret W. Tiller
chairperson

Task Force to Identify Actuarial Issues for State and Federal Guaranty Funds

The task force's original charge was expanded in 1990-91 because the federal government began to evaluate its contingent liabilities for a broad range of guaranty-type programs and sought input from the actuarial profession. The task force's activities included:

—Commenting to Congress through the Congressional Research Service on a consulting firm's report on the financial soundness of the Federal Housing

Administration's (FHA) Mutual Insurance Fund.

—Working with the assistant comptroller of the FHA to ensure that he understood the task force's comments and perspective on the FHA fund.

—Reviewing studies of government-sponsored enterprises (GSEs) by the U.S. Treasury, Office of Management and Budget (OMB), and General Accounting Office (GAO). Congress requested these studies as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

The GAO report called for the establishment of a federal enterprise regulatory board to oversee the activities of GSEs and called for improved capital standards for GSEs.

The task force has submitted its final report and recommendations to the Academy's Board of Directors. The task force made two recommendations:

—If, in the opinion of Academy staff, Congress is likely to take action to create a federal enterprise regulatory board, the Academy should appoint a task force to track and participate in this activity.

—The Academy should be involved extensively in the solvency debate at both the federal and state level. It seems vital that the Academy take part in these discussions, because they may help to define the future of the actuary with regard to the solvency of insurance companies.

John C. Angle
chairperson

Committee on Discipline

The committee took final action on a number of disciplinary matters and prepared to hand over outstanding cases to the Actuarial Board for Counseling and Discipline (ABCD), which began handling disciplinary matters as of January 1. (See the January 1992 *Update* for a report on the Committee on Discipline's final actions.)

John A. Fibiger
chairperson

Changes to 1991 Loss Reserve Opinion Instructions

Three revisions to the 1991 annual statement instructions for the statement of actuarial opinion on casualty loss reserves were adopted by the National Association of Insurance Commissioners (NAIC) at its meeting in December. These revisions are detailed on page 7 in the "NAIC Report."

NONFORFEITURE LAW II, from page 5

A major portion of the bill is concerned with universal life. Definitions are included, and both fixed-premium and flexible-premium forms have prescribed methods and limitations for benefit calculation. The flexible-premium limitations have been characterized as rate-fixing in nature, in that there are limits on all elements, and none can be offset by a change in another. A higher credited interest rate, for example, will not offset a higher mortality charge. Smaller (less than \$10,000) policies are singled out for special treatment, with a lower allowable per policy limit.

Values resulting from unscheduled increases in amount of insurance are to be treated as if the change were a new policy, except for the per policy expense. This per policy charge may be indexed using the Consumer Price Index.

A minor change in the smoothness test has resulted in many of the comments received to date. This was the requirement that no percentage after the later of the second or the fifth policy anniversary (with allowance for those policies that do not develop values that early) could differ by more than 10% from that applicable in the preceding period. To allow for the

common provision of grading to the full reserve at a specified year, the current draft allows such a change once during the life of the policy. The test, even with the change, has been criticized as favoring high-premium policies while penalizing others.

In effect, there are two changes to the exceptions section of the Standard Nonforfeiture Law with SNFLII. SNFLII would apply to group universal life, which was not included in the original law (probably because universal life, group or individual, didn't exist yet). SNFLII also makes clear that the "pure endowments" not covered are pure endowment policies.

The question of overall equity, whether prescribed by statute or by regulation as is mandated by SNFLII, is of concern to actuaries. Different aspects of equity were implicit in the work of the Actuarial Standards Board in developing standards of practice, such as those on risk classification and property/casualty ratemaking. Actuarial equity is not solely a life insurance issue.

The time to comment is now. Address comments to the NAIC Legal Department at 120 W. 12th Street, Suite 1100, Kansas City, MO 64105. Copies of the exposure draft are available upon request from the Academy's Washington office.

CALL FOR NOMINATIONS

The Nominating Committee is seeking your nominations for the Academy's Board of Directors. Nominations will be presented to the membership for election at the Academy's Annual Meeting next September.

Please forward your nominees' names to Nominating Committee Chairperson Harold J. Brownlee, in care of the Academy, using the postcard included in this mailing of *The Actuarial Update*. Please send your nominations promptly.

Sloan serves on the NAIC Nonforfeiture Working Group. "It isn't really a controversy," he notes, "but there are two possible pronunciations of the acronym SNFLII. Whether you want to call it sniffly or sinfully though, you should be sure to obtain a copy and express your opinions."