

TRANSACTIONS

APRIL, 1967

COMMITTEE REPORTS

REPORT ON "THE ACTUARY"

MR. ANDREW C. WEBSTER: The success of this newsletter is going to depend on the material that we receive from the members of the Society. All is grist to our mill. We may not publish everything. We will observe the laws of libel and slander as nearly as we can. But I ask for contributions.

I would also like to have any comments sent to the Editor about what you think the magazine should contain. It is a little difficult to sort out the current items of temporary interest from items of permanent interest, but we are trying to do this and trying to keep it on a level that can be easily read and, I should say, easily understood.

This does not mean that you do not send in anything with formulas. I do not think that we would print Mr. Lauer's paper in "The Actuary" had it not been accepted by the *Transactions*, but we are willing to consider actuarial notes which are of some consequence.

I again appeal to you, as I finish this brief discussion, for help in making our task a little harder in separating the wheat from the chaff but a little more interesting for the readers of "The Actuary."

REPORT OF THE COMMITTEE TO STUDY PENSION PLAN PROBLEMS

MR. JOHN H. MILLER: Last fall the Committee devoted considerable time to a study of the question of integration of private pension benefits with social security and, in response to the invitation of the Commissioner of Internal Revenue, submitted a letter to him stating the views of the members, as individuals, on this issue.

Yesterday the Committee met and reviewed the status of the proposed "Statement of Actuarial Principles and Practices," which was discussed last fall at the Annual Meeting. We also discussed several of the pension topics which are receiving so much current attention, both in Washington and in business and labor circles.

The Committee will now address itself to the development of a report to the Board containing an actuarial analysis and critique of the implications to actuaries of such issues as disclosure, vesting, guarantee funds, and funding requirements. As an example, the Javits bill, one of several now before Congress, places a great deal of reliance on actuaries and actuarial reports, and we should consider whether we are ready, as actuaries, to undertake these obligations should something like this be enacted.

The Committee, I might say, would welcome views from anyone on any of these issues. Our approach, of course, is analytical and technical not political, but we need a good objective analysis of these very important issues and will welcome any contributions from any members.

REPORT OF THE COMMITTEE TO STUDY PENSION ACCOUNTING

MR. FRANK L. GRIFFIN, JR.: The Society's Special Committee To Study Pension Accounting was first appointed in 1960, as a result of a research project put under way by the American Institute of Certified Public Accountants (AICPA) to study, evaluate, and compare various proposals for a consistent approach to pension cost accounting. The original purpose of this Committee was to co-operate with the Accounting Principles Board's Subcommittee on Pensions and the research staff of the AICPA in exploring actuarial aspects of the pension accounting question, in making actuarial counsel available, and in reviewing various drafts of material developed by the accountants in connection with their research study. One of the Committee's primary objectives, of course, was to insure that responsibilities falling in the province of the actuary were properly reserved to the actuary.

Following two preliminary drafts of the study, which were duly reviewed by the Society's Committee, a much-improved final study (now commonly known as the "Hicks Report") was issued in 1965. The Accounting Principles Board then drafted an opinion, designed to furnish guidelines for the proper charging of pension costs in corporate financial statements. After issuance of the preliminary "exposure draft" in July, 1966, and discussions with various interested groups, including actuaries, *APB Opinion No. 8* was issued in final form in November, 1966.

Briefly, the background of the accounting research study and opinion is as follows. Until the issuance of *Opinion No. 8*, accounting for the costs of pension plans was in most instances done on a cash rather than on an accrual basis. Thus pension accounting usually followed actual contributions. Only in rare instances was an attempt made to reflect pension expenses as they accrued, on the basis of a long-range relatively level cost. A company with a funded plan might contribute any amount within the rather wide limits considered acceptable by the Internal Revenue Service. A company with an unfunded plan, while not having that flexibility, might start in with insignificant costs but be faced with the prospect of rapidly mounting future costs.

Recognition of the fact that wide variation in reported pension costs could result in material distortion of a company's earnings statement aroused the concern of many accountants. Also concerned was the United States Securities and Exchange Commission.

The most significant requirement of *APB Opinion No. 8* is that costs be reported on the accrual basis, regardless of the manner in which contributions are being made for funding purposes or whether the plan is being funded at all in advance of retirement. Guidelines are given in the form of maximum and minimum pension charges, and it is contemplated that a company will adopt a course for accounting purposes and follow it consistently from year to year rather than vary the course at will.

Other significant requirements of the new accounting rules concern the inclusion of unfunded plans within the scope of the *Opinion*, recognition by some acceptable method of the excess of market over book values of assets, the spreading of actuarial gains and losses, recognition of costs with respect to all employees who may reasonably be expected to become participants after completion of a waiting period, and disclosure of pertinent facts about the plan in footnotes to the company's annual statement. The *Opinion* also discusses actuarial cost methods and states that the pay-as-you-go and terminal funding approaches are not acceptable for the determination of accounting charges.

It is interesting to note that the *Opinion* recognizes that computation of pension costs requires the use of actuarial techniques and judgment and that pension costs should generally be determined from a study by an actuary. While the *Opinion* sets forth some actuarial concepts in order to describe accounting for pension costs and for the information of the accountant who will apply the *Opinion*, it recognizes the actuaries' responsibilities.

Prior to the final issuance of *APB Opinion No. 8*, the Society's Committee, acting in concert with representatives of a similar committee of the Conference of Actuaries in Public Practice, and with representatives of the Society Committee To Study Pension Plan Problems, met with the APB Subcommittee on Pensions to make a number of suggestions relative to changes in the exposure draft. Many, but not all, of these suggestions were reflected in the final *Opinion*.

It would be a mistake to assume that the issuance of *APB Opinion No. 8* means the end to problems of accounting for pension costs. The *Opinion* itself leaves many questions unanswered, and there remain, as of this writing, differences of opinion among accountants as to the proper interpretation of certain paragraphs. While actuaries and accountants who are closely concerned with this question may have resolved in their own minds most of the problems of interpretation, these interpretations may differ from one firm to another. Nonetheless, it is to be expected that the issuance of *Opinion No. 8* will bring about much greater uniformity than

heretofore existed in the accounting for pension costs. It may have effects on funding as well.

As time goes on, the remaining areas of vagueness or disagreement as to proper interpretation will probably narrow, either through the issuance by the Accounting Principles Board of clarifying bulletins or through other developments. In a few years perhaps, especially if actuaries secure their much-desired accreditation through the Academy, accountants may see fit to rewrite their *Opinion* in terms of accepting certifications from accredited actuaries. In this connection, this particular route to accreditation is recognized by the accountants who have stated in their *Opinion* that membership in the Academy is one acceptable evidence of actuarial qualification.

DIGEST OF DISCUSSION

New Orleans Regional Meeting

MR. HENRY B. RAMSEY, JR.: I would like to comment on the significance of this as I see it. My responsibilities are in the accounting area, and accountants have taken much encouragement from what they feel to be a happy result of the work of actuaries and accountants together in this instance.

As I am sure you are well aware, there is much activity currently with regard to what the proper accounting principles are for life insurance companies. Too much, I fear, we actuaries have tended to take a high and mighty attitude, and, while there is no question of the great lack of understanding among accountants of the particular difficulties of life insurance accounting, I think that it behooves us to take a positive attitude. The Joint Committee that has been formed is a step in that direction.

REPORT OF THE EDUCATION AND EXAMINATION COMMITTEE

MR. JULIUS VOGEL: This is a summary of the report of the Education and Examination Committee presented to the Board of Governors yesterday, covering the work of the Committee in the last six months.

Perhaps the most significant development in the examination area is that the number of students writing Parts 1, 2, and 3 is declining. In 1966, registration for Parts 1, 2, and 3 was down about 15 per cent from the highs reached in 1964. This is, of course, a matter of concern, and we are trying to assemble statistics to determine, if possible, what has caused the decline. The Public Relations Committee is looking into this also.

Centralized grading of essay questions on the examinations beyond Part 3 continues to be an effective means of coping with the current volume of candidates in these examinations. Centralized grading is a procedure whereby the entire Examination Part Committee convenes for a three- or four-day meeting in a centrally located city and accomplishes much of the grading work in the course of that meeting. The first central grading session was held for Part 4 in 1964. In 1966, we used central grading in five of our examinations; in 1967, we expect to use this technique in at least seven examinations and possibly one or two more.

In the area of textbooks, revisions of Jordan's *Life Contingencies* and Spiegelman's *Introduction to Demography* are near completion and should be available for the 1968 examinations. Both these authors deserve the gratitude of the Society for their efforts on behalf of its education system. Also, Mr. E. L. Bartleson has agreed to undertake the updating of *Health Insurance Provided through Individual Policies*. This too is very welcome news. A big remaining problem is to find a replacement for Wightman's *Life Insurance Statements and Accounts*, which is now rather out of date. The best immediate hope seems to lie in the direction of securing up-to-date study note material.

I should also mention that the Canadian Institute of Actuaries has appointed a subcommittee to provide a liaison with the Society of Actuaries in the area of education and examination. This could prove to be a significant and helpful development.

Finally, I want to refer to our plans to put the Society's examination record-keeping on a magnetic tape system. Manual records are being keypunched and transferred to tape in order to establish the file as of the completion of the May, 1966, examinations. The tape will then be updated

to reflect the results of the November, 1966, examinations. The resulting tape output will be compared with the Society's manual records as a means of testing the program and making sure that all information has been transcribed properly. When it is fully installed, the new system will not only maintain the examination record of each student but will also generate many of the forms required for the administration of the examinations.

REPORT OF THE COMMITTEE ON PROFESSIONAL CONDUCT

MR. FREDERICK P. SLOAT: The Constitution of the Society places in the Board of Governors the power to consider and to take action with respect to questions which may arise as to the conduct of a Member. In order to assist the Board of Governors and the Society in achieving the objectives of the Constitution and, more importantly, to guide Members of the Society when they encounter questions of professional conduct as actuaries, the "Guides to Professional Conduct" have been promulgated by the Board. As is true of codes of ethics generally, these Guides deal with precepts and principles only. They are not precise rules and are subject to interpretations in relation to a variety of circumstances that occur in practice. Any Member wishing guidance in the application of these Guides to a particular set of facts is urged to consult the Committee on Professional Conduct.

The function of the Committee, therefore, is to recommend guides for adoption by the Board and to aid Members in the interpretation of the Guides for various situations. It does not deal with actual infractions of the Guides. The Committee has responded to inquiries from Members regarding interpretations of the Guides, and it has been suggested that such information should be made available to all Members and not limited to those who seek guidance.

Accordingly, the Committee has proposed the issuance of interpretative opinions which would point up the application of the Guides to specific types of situations. It believes that these would be more useful if issued from time to time rather than as one compilation. Such a schedule would certainly get them into the hands of the Members more promptly. The Committee welcomes suggestions of Members as to matters which might be included in such interpretative opinions. These may be submitted in writing to the chairman of the Committee or to any of its members.

The Committee is concerned about the problems presented by the divergency of the guides of the Society and the Academy. Most Members of the Society are also Members of the Academy, and this makes them subject to the guides of both organizations. This indicates the desirability of the guides being as comparable as possible. The Academy, of course, includes members of four actuarial organizations. It would not be inconsistent for any of the four to include in its own guides matters which are

not in the Academy guides. However, the omission in, say, the Society's Guides of any matter covered by the Academy guides would have applicability only to Members who are not also Academy Members. Further, there are potential problems where the Society and Academy guides are similar but have differences in wording. The Committee is cognizant of these risks in this situation and welcomes the opportunity to assist in obtaining more uniformity in the guides. It is pleased that the Academy has expressed its intention to move in this direction.

REPORT OF THE COMMITTEE ON STATUS AND ACCREDITATION

MR. ANDREW C. WEBSTER: As a preface to the report on the current state of accreditation, it might be well to refer to the discussions that took place in 1963 and 1964 prior to the adoption by the Society Members of a resolution endorsing the recommended formation of the American Academy of Actuaries. Early in 1964, the Members of the Society were advised by letter, in considerable detail, about the plans for the Academy.

The first step proposed was to get a federal charter for the Academy. This route was prompted by the requirements of the Federal Welfare and Pension Plans Disclosure Act and with the thought that the possession of a federal charter would help in obtaining recognition by the states. The letter to the Members mentioned that "obtaining a Charter and organization of the Academy are only the first steps towards accreditation. The next step will be to attempt to have legislation passed in each state, providing for the certification of Actuaries."

The unsuccessful attempts to obtain a federal charter have already been reported to the members, as has the action of the Academy in obtaining an Illinois charter. Thus armed, the Academy has endeavored to obtain recognition by means of legislation in various key states, and, in so doing, we have the blessing of the NAIC. To date we have not been too successful, although we have in Indiana a statute providing for the certification of actuaries. Legislation for such certification is a local matter, and the Committee has been enlisting the help of local company counsel. The legislation sought parallels that of the C.P.A.'s in that it is permissive legislation requiring certification for the public practice of actuarial science. This does not forbid others from practicing actuarial science for employers, but it would prevent the noncertified actuary from signing certain reports.

In attempting to obtain legislation, the procedures have uncovered certain areas of misunderstanding, and it was the recommendation of the Academy's Board of Directors that the import of legal recognition be again brought to the attention of the members of the four actuarial bodies who sponsored the Academy.

State recognition or licensing of any profession—law, medicine, architecture, and so forth—gives the state the right to determine who shall and who shall not be certified or licensed according to the standards set by the state. This is a sovereign right of the state and a right that will not be

ceded to any private organization. In C.P.A. practice, for example, the state uses examinations furnished by the institute of C.P.A.'s, and it is most likely that for actuaries the Academy examinations will be used. There is, however, no guarantee on this in connection with any profession.

The state has the choice of (1) accepting the generally prevailing standards, as has been done with the C.P.A.'s; (2) setting higher standards; or (3) setting lower standards. The tendency, if we may judge from the record, is to set higher standards or to accept the generally prevailing standards. Actuaries are no different from any other profession, in relation to the state, and the state's right to certify is the price of recognition of any profession.

The legislation will be a local matter, that is, there is no model bill which will be proposed in identical terms in every state. Basically, each state bill will define the public practice of actuarial science. Definitions may vary, but not too much. They should be broad, bearing in mind that the Academy membership includes actuaries in other than life fields and also that enumeration implies exclusion.

These two items—the rights of the state and the definition of the public practice of actuarial science—seem to have given rise to most of the misunderstanding.

There have been other questions, mostly of administrative procedure within the state, and these will have to be answered individually. There is still the possibility, which was advanced at the time of the 1963, 1964 discussions, that certification be a matter of administrative order, by the superintendent of insurance, for example, rather than by legislation. The end result of our present endeavors is that it may take somewhat longer than we imagined to get recognition.

Two recent items are encouraging from the viewpoint of actuarial recognition. One of these is the requirement under Senator Javits' pension bill, now before the Senate, calling for actuarial valuation of pension funds and giving a proposed pension commission the right to accredit actuaries. We have already asked to be allowed to file a statement about the American Academy of Actuaries at the hearings on the Javits bill.

The other lies in the tentative draft of the Civil Service Commission, Classification Standard for Actuaries. The draft was submitted to the Society, and already the Public Relations Committee and the Education and Examination Committee have suggested recognition of the Society and of the other actuarial bodies in setting up standards for employment and for promotion.

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DIGEST OF DISCUSSION

New York Regional Meeting

MR. ERNEST J. MOORHEAD: To say that Boston was thrown into an uproar by the arrival in the legislative hopper of a bill to regulate actuaries would be libelous, inappropriate, and accurate. It is with that in mind that I add my voice to that of Mr. Webster in urging local study of this subject in a great deal more detail than we did in Massachusetts until we were forced to study it because the bill might be going through the legislature in 1967—which happily has turned out not to be the case.

Mr. Webster's report summarizes extremely well what the key points are. If all of us will now exert ourselves to the extent of getting a copy of the model bill, studying what is meant by "the public practice of actuarial science," measuring the advantages to come from accreditation against the price we must pay for it, and relating the question to the particular problems of our own areas, we will be a great deal better off, will understand why we are doing what we are doing, and will be prepared to give whatever is done the support that it needs.

Mr. Webster particularly referred to the distinction between the legislative approach and the administrative approach, which, I think, especially deserves study.

MR. GEORGE BRUMMER: Mr. Webster's report brought us up to date on the work and progress of the Committee without discussing specific situations. A law concerning the certification of actuaries was enacted this spring and is now in force in the state of Indiana. The Commissioner of Insurance is responsible for administering the law and will determine what documents, filings, or financial statements must bear the signature of a certified actuary and the requirements for certification. Subject to limits stated in the law, these may be in the form of examinations or be based solely on membership in the Academy of Actuaries.

I do not know whether similar laws have been enacted to date in other states, nor do I know whether actuaries who neither reside nor are employed in Indiana will have to have this certification. I believe that such information should be distributed to Members of the Society through committee reports in the *Transactions* or the new publication, "The Actuary," so that each of us will know what steps we have to take.

MR. WEBSTER: I just want to make one point about the model bill. There is no one bill, so there is not much point in writing to me and asking for a copy of the model bill, because, before introduction of a bill is even

considered, it has to be conformed to the legislative requirements of each state. One of the problems that arose in the Boston Tea Party was that this model bill had not been conformed to the legislative requirements of Massachusetts.

When we are going into a state, we will have the bill conformed and then it is open for discussion.

New Orleans Regional Meeting

MR. WENDELL A. MILLIMAN: You are all familiar, of course, with the Society's examinations, but the question of what the Academy examinations will be is still not fully resolved.

At a meeting of the Board of the Academy last week, action was taken, in effect, to put the Academy in the position of adopting the Society of Actuaries or Casualty Society examinations as the examinations for the Academy. It is hoped that a procedure may be worked out whereby the examinations of these two bodies will bear the label of the Academy as well as the label of the Society or the Casualty Society.

I thought that it might be helpful if everybody recognized the fact that we are not contemplating a complete new set of examinations for the Academy. The examination-procedure route will be the same as that with which you are already familiar.

MR. CHARLES H. CONNOLLY: A few months back we heard of the formation of a new body, consisting, I think originally, of about nine people, who took the title of "American Society of Pension Actuaries," with their headquarters in Fort Worth. It was really difficult for me to find out much about them. I talked to others in Dallas and Fort Worth who were in consulting work and asked them if they knew anything. Therefore, most of what I have to say can be classified as hearsay.

Apparently the members of this group felt the need for a society of their own, probably as a result of not being accepted by the Academy or the realization that they would not be if they were to apply. One was a C.P.A. and the others were all C.L.U.'s. They have been in business for a long time setting up small pension plans, usually selling ordinary life and recommending an auxiliary fund, invested perhaps with the trust department of a bank. They would do the actuarial work to determine the necessary contributions to the side fund to convert at age 65 to income.

I have seen the application for membership, and there are currently two classes of membership. For example, you can become an associate upon application; the payment is \$15. On the other hand, you can become a member by sending in an application, together with a \$20 fee, and also

by taking an examination. The examination consists of one question which is published in the application. You are to determine the net level premium for a benefit of \$10,000 in event of death prior to 65 and a life annuity of \$100 starting at 65, if you survive to that time. You are to use what they call the 1949 annuity table with interest at 4 per cent.

It has affected considerably the situation in Texas insofar as accreditation goes, because we heard, before we actually introduced the bill in the legislative session this year, that members of this group had lined up necessary support with the thought of tacking on an amendment to recognize their body as well as the Academy. Therefore, we feel that it will be necessary to spend the next two years in educating our legislators.