RECORD OF SOCIETY OF ACTUARIES
1986 VOL. 12 NO. 2

AMERICAN ACADEMY OF ACTUARIES COMMITTEE ON PRINCIPLES AND PRACTICES FOR DIVIDENDS AND OTHER NON-GUARANTEED ELEMENTS

Moderator: WILLIAM T. TOZER
Panelists: JOHN A. FIBIGER
JAMES W. KEMBLE
RICHARD M. STENSON
Recorder: ROBERT M. ELDER

- o Brief status report on Interim Actuarial Standards Board (IASB) including how this Committee's Exposure Draft affects the IASB
- o Redetermination of Non-Guaranteed Pricing Elements Recommendations -- Academy Exposure draft
- o Actuarial responsibilities to the various publics relative to non-guaranteed pricing functions, i.e., insurance regulators and potential buyers

MR. WILLIAM T. TOZER: I am chairman of the Subcommittee on Dividends and Other Non-Guaranteed Elements of the Life Committee of the IASB. This Subcommittee has two charges as its title implies. The first charge is policyholder dividends. In 1980, the American Academy of Actuaries adopted standards for policyholder dividends paid on life insurance by mutual insurance companies. This Subcommittee has modified these standards to apply to both stock and mutual companies. Also, the modified standards apply to annuities as well as life insurance. In addition, the new standards cover both new issues and in force business. The final recommendations were adopted by the American Academy of Actuaries' Board of Directors on October 8, 1985, and are effective after December 31, 1987. A revised set of instructions for Schedule M was submitted to the NAIC. At the March 1986 meeting of the NAIC, the Blanks Task Force adopted these changes. It is expected that the changes will be finally

adopted by the NAIC at its June meeting. If that is the case, it is expected to apply to the 1986 Statement that will be filed in 1987. This will complete the Subcommittee's work in the area of policyholder dividends.

The second charge covers the area of other non-guaranteed elements. Two Subcommittee members, Jim Kemble and Dick Stenson, will cover this subject.

When the Committee began its work, it was a Committee of the American Academy of Actuaries. Since then, the Interim Actuarial Standards Board has been established. We are now a Subcommittee of the Life Committee of the Interim Actuarial Standards Board. Our first speaker, John Fibiger, is chairman of the Interim Actuarial Standards Board.

MR. JOHN A. FIBIGER: To bring you up to date on the IASB, we had our first organizational meeting in October 1985.

We have had two substantive meetings, both two day sessions, one in January and one in April. Our meeting schedule is normally to meet the second Friday of each quarter. It is a Friday meeting so that, if necessary, it can go over to Saturday. We have organized into five separate committees -- Casualty, under the direction of Charles Bryan; Health, under Ron Wolf; Life, under Walter Miller; Pensions, under Tom Levy; and a Specialty committee, under Jarvis Farley. I'm going to describe the work of at least a couple of these committees, and you can see why we have the Specialty committee.

The two main standards under consideration of the Life committee are the exposure draft being discussed in this presentation and standards of practice for valuation actuaries. What has happened, because of the existence of the IASB, is that organizations which might otherwise deal with this issue, such as the ACLI, for example, have said that they will confine their activities, with respect to the valuation actuary, to the regulatory process. They will turn over to the actuarial profession and its standards board the question of what type of standards of practice valuation actuaries should have. This includes tests that should be made, the public reports and certifications that should be made, as well as private actions that may be taken by a valuation actuary, arising out of those tests. Some of the board members of the ACLI have been

concerned that the valuation actuary might be in a position, in effect, to go directly to the regulator and usurp privileges that are properly felt to be those of management and the company's board of directors. The existence of the standards board means that the profession can regulate its practitioners, and the trade association can deal with the regulatory process. It has been very helpful, I believe, in helping the ACLI Task Force on the Valuation Actuary come to a conclusion.

In Pensions, there has been a project in the Academy's Pension Committee, which is now the Pension Committee of the IASB, to do a rewriting and a restating of some of the fundamentals of pension practice. The Committee has had a rather striking outside intervention, namely the Financial Accounting Standards 87 and 88 just recently promulgated by the Financial Accounting Standards Board. The Pension Committee is working very rapidly and will try to have an exposure draft ready for our July 18, 1986 meeting, and standards in place, hopefully, well before the end of the year on how to comply with the requirements of FAS 87 and 88.

The Specialty committee under Jarvis Farley has one project right now. That is actuarial principles and standards for continuing care retirement communities. These communities typically provide housing at the appropriate level for an individual's needs as well as a certain amount of pre-funding of medical care. You may go into one of these communities, live in a separate home, move into an apartment where you cook your own meals, move into a residence apartment where meals are provided, go from there into a full hospital facility and move back into a nursing home. There have been a number of problems with these communities which were started by charitable organizations because they have been underfunded. There are aspects of pension plans. There are aspects of life insurance. There are aspects of health insurance. It is one of those areas that crosses lines and thus has been given to the Specialty committee. The idea of a specialty committee is, in effect, a catchall; both to take areas in which a standard may be needed, which do not fall under the Casualty, Health, Life, or Pension specialties and, secondly, to deal in areas which cross over a number of lines. One of the other projects that the Specialty committee may be taking on is the question of standards of practice for actuaries giving testimony.

We have a couple of very interesting overall projects. First, the Academy of Actuaries' Yearbook contains all of the many standards which have several different formats. We are going to try, without changing the text material, to pick a standard format. Secondly, and what is going to be even more fascinating, is to resolve principles of actuarial practice across different lines. In particular, one that obviously is going to be a very difficult one to resolve, because it involves the regulatory process as well as a number of practices within companies and within the profession, is the question of discounting.

Typically, you find that many casualty actuaries will not discount liabilities. Life actuaries and pension actuaries typically will. There are some reasons for it. In general, the obligations that people in several specialties have to deal with are relatively fixed. There is an amount of life insurance in force. There is a monthly benefit for disability income. There is a specific, defined pension. In property and casualty insurance, however, many of the liabilities are not known for a number of years, so that both for conservatism as well as the uncertain nature of the principal sum or the amount to be paid in a specific settlement, these reserves have typically not been discounted. Obviously, to apply a discounting factor to a sum that could vary by 200% or 300% introduces, at least in the minds of a lot of casualty actuaries, a pseudo-scientific feature. It also, in effect, reduces reserves that can be set up, so they have used non-discounting to add an extra element of conservatism. With an actuarial standards board, we're going to have to address these issues because, in effect, there is implicit conservatism. Perhaps, the principle will be that when the principal is known, it should be discounted because these techniques cross over. For example, for a structured settlement in which a $500,000 obligation is funded $100,000 a year over a five year period, a life actuary will discount and may put up that liability at $400,000. A casualty actuary may put it up non-discounted at $500,000.

There is going to be a lot of interesting work for us to do over the next few years, and we are involved in a discovery project right now to find out just what are the basic principles.

I do want to stress that this is an interim actuarial standards board. I think all of the members of it have been recruited on the premise that it is interim. None of us really demand to have a reappointment. Those of you who are familiar with the Financial Accounting Standards Board know that the members of the FASB are rather highly compensated for their services. We are not compensated at all. This is a volunteer effort. It is, I hope, something that will continue to be a volunteer effort on the part of the actuarial profession. We are trying not to put on an over-elaborate superstructure. We are trying to use the technique of publishing exposure drafts; receiving comments on them; putting out a final standard for approval; and then having it approved, at least during the interim phase, by the Board of the American Academy of Actuaries. We're trying to follow due process.

In about 18 months, the profession will have an opportunity to decide whether the interim board becomes a permanent board and, if so, how it is governed -- whether it is governed by one of the actuarial organizations, by a committee drawn from representatives of each of the actuarial organizations, or by a parent committee. The FASB has a Financial Accounting Federation that serves as the parent committee. I think all of us on the Interim Actuarial Standards Board have been convinced, and certainly have increased our conviction, that some type of body to deal with actuarial standards is needed.

We are very pleased with the progress that we have made so far. The final exposure draft for continuing care retirement communities will be voted on at our next meeting, and there are a number of other projects well under way. I think that if we can work out the governing and funding issues, you will find that the IASB becomes an interim step to a permanent actuarial standards board.

MR. RICHARD M. STENSON: My topic is actuarial responsibility to the various publics relative to non- guaranteed pricing functions. Responses could range from a responsibility that is specifically required by law and regulation, all the way to a feeling of significant concern for proper public understanding of the products and contracts that we offer.

We must also consider the relationship of the actuary and the actuary's management. The actuary could be an employee who is part of the top management

team of his or her company and be involved in strategic decision making. On the other hand, the actuary may wear only the hat of the pricing actuary, who is basically providing professional analysis and advice to management as an employee, or a consultant, but not as part of top management. Much of the exposure draft that we have now and the principles that have already come out on participating policies, both for mutuals and stocks, have focused on the relationship between the actuary and the actuary's employer. A lot of the emphasis calls upon the actuary as a professional. In other words, the actuary is asked to be sure that the advice that is given is complete and thorough. Now, there are some who would think that even this requirement is intrusive. I have trouble seeing that, myself. I think management certainly will call its own shots. The kind of arrangement that I'm talking about is certainly one where the actuary is providing advice, but the company will make the decisions as to what it's going to do. However, the actuary, in giving advice, must do so in a context that makes it certain that management understands the implications of what the actuary is being asked to advise and comment on.

Let me back up to the question of the responsibility of the actuary to the public. Let's talk about it on a company level first. That may not be an actuarial concern but it can set the concept into context. Again, there is that same range of opinion that could be taken. From a point that there's virtually no responsibility of the company beyond what's set out in law and regulations, to a position that there ought to be much more concern. I don't think anybody would argue that even if we had zero regulation and law, the customer ought not to have a contract that spells out the basic obligations and relationships between the parties. What we're talking about here is a set of major issues centering around public understanding and the question of whether the buyers know what they have purchased beyond the basic contract guarantees. There are issues that relate to illustrated values versus guaranteed values. Does the contractholder or the purchaser understand both? Does he understand how they would compare with currently declared rates and charges? What should the contractholder expect in the future? When he sees the numbers, what does he think they mean? How does he think they are going to change, if circumstances change?

We have to realize that when we're talking about this, there is a whole array of contracts that have these qualities. Term contracts, where the premium is not guaranteed and may be changed every year in the future, have some of these problems. With Universal Life contracts, it's not just the interest rate declaration, it would also be the mortality rate declaration. How do people understand these? How do they use the facts that they have, in making judgments as to choices between different contracts or choices between different companies, or between different places to put their money? A consumer would have to be pretty sophisticated to understand all of that. When we're dealing with contracts that have non-guaranteed elements, we also have to recognize that we're in an area where there are evolving practices and evolving product design.

One view, as noted, could be that current law and current regulation are enough. No need for the actuarial profession or anybody else to do any more. I think certainly that is a rational and a logical position. It probably would be okay as long as no perception of problems begins to appear in the point of view of the public, the regulators, the consumer advocates, etc. If that does happen, we can have something described in what some of the Subcommittee members have called Walt Miller's "vacuum speech." Namely, as those problems happen, there may be solutions developed that the industry or the profession may not be able to join in if the vacuum is left open.

Getting back to the role of the actuary within the company, I think the vacuum can come about there in two ways. There is not only the question of whether or not management wants to get involved in a particular activity or in a particular disclosure process. There is also the role of the actuary dealing, as a professional, with his client the company, where there might be a vacuum if the actuary has not given the background and implication of pricing recommendations to management on a thorough and logical basis. Management might make judgments differently if it had all of that information.

This is a very difficult and significant issue. It's one of the reasons why the Subcommittee has focused quite a bit on the relationship of the actuary to the management of the company. The Subcommittee has tried, particularly on these new contracts, not to pick a set of rules which it thinks would be best, nor to

create a set of rules where none yet exist, but to recognize that there might be many different ways that companies or actuaries want to operate with these contracts -- asking, however, the actuaries to be sure that they do so within a certain frame of reference or context and that that is communicated to their management.

I will comment that we've gotten some reactions to the exposure draft already. There are some who think it's going too far to ask for this kind of communication. They think that we're hamstringing the actuary and are trying to tell the actuary how to do things in areas that should be left to the actuary's professional judgment, or that we're trying to bless a particular method. That is not what we're trying to do. We're trying to get the actuaries to make sure that the set of principles with which they work is consistent and is communicated. Now, on the other hand, some people think we haven't gone far enough in actively seeking better public understanding of these products. When we get to the larger issue of what the actuary should do as a professional in dealing directly with the public and regulators, it's my belief that we've focused primarily and properly on the relationship of the actuary to his employer, at least up to this point of time and as related to contracts with non-guaranteed elements. There has been work that we've done with Schedule M, for participating life insurance, that I believe philosophically goes somewhat beyond that and finds a role for the actuary to have a professional concern to the general buying public as well.

MR. JAMES W. KEMBLE: The Subcommittee's progress has evolved from the true mutual participating policy to the sort of contract which, as Dick has already suggested, some people will say is sufficient unto itself, and we don't have any business telling people how they should design, price, market, and reprice. Yet there are some very complex issues here which we have to address, as a profession, if we don't want someone else to address them for us. That's our attempt. We need to provide the professional actuary with some advice on how to go about practicing his or her profession with regard to products which contain promises which management has a responsibility to recognize, and to implement as the product evolves over a period of time. I'm going to emphasize again, that this recommendation covers the report that we as professional actuaries will deliver to our peers, our bosses, and the management of the life

insurance company whose products we are discussing. Management is the group which is going to have to make the decisions. Management may be one person, or it may be a committee. It's essential that it knows the ramifications of its decisions when it makes them. That's what we're trying to communicate in this draft.

The draft contains six sections, plus one interpretation. There are eleven recommendations. The first one tells us we need to make a report. The other ten give some general, broad guidelines as to what should be contained in that report. Throughout this exposure draft, we use the term "policy" to mean the company's policy with regard to this particular product. The form itself is a contract. That's a distinction which I think is pretty clear, but when you're reading it quickly, remember, policy means company policy as opposed to a life insurance policy.

In the general section, the first section, there is a discussion about when such a report should be made. A report should be made when a product is first developed and a policy has been developed for that product. And then, even more importantly, when the charges or benefits which can vary are redetermined, a report is also necessary. Where is it applicable? It's applicable to contracts for which charges or benefits may vary at the discretion of the company. Some examples, are Universal Life, Indeterminate Premium policies, and so-called Excess Interest policies. There also are ART contracts which have maximum guaranteed premiums but premiums which start at less than the maximum. All of these are the sorts of contracts to which this draft applies. It does not apply to contracts, specifically, which are contractually tied to separate accounts or to defined indexes of one sort or another.

The draft quotes Paragraph B of the Academy's Interpretative Opinion 4 to define what we consider are the appropriate actuarial principles for this particular recommendation.

Section 2 covers the actuary's report. It outlines what we consider to be the two essential obligations that the actuary has in this area. First, the actuary must do a complete and thorough job in analyzing and putting together recommendations for the initial determination or the redetermination of varying

benefits or premiums. And secondly, the actuary must prepare a report which discloses to his or her management everything that management needs to know in order to make a knowledgeable and reasonable decision with regard to these varying aspects. Recommendation 1 merely says, that whenever an actuary makes a recommendation or gives advice to the company regarding this type of policy, that it should be accompanied by a report which documents and gives full disclosure to the management all of the elements which are necessary for management to make its decision.

Section 3 covers what we call determination or redetermination policies. We believe that the real consideration concerns redetermination and how redeterminations relate to the company's policy which was established at the time a contract was issued, or at the time the contract was originally developed, and how that policy has since been amended. It suggests the need for the existence of a company policy. We have already had at least one response that says we don't need a company policy -- that we're not going to have a policy with regard to these contracts. Generally speaking, that's not a particularly satisfactory policy. We have a section having to do with regulatory aspects, and I suspect it might not be too satisfactory to a lot of the regulators you deal with. If that is the company policy, then the actuary needs to know that. In those instances, the actuary is going to have to determine some policy on behalf of the company. The actuary's professional responsibility is to determine and to redetermine the indeterminate elements within the framework of management policy.

What are some examples of company policy? One is, that in the future, we intend to change our varying units in indeterminate elements as we expect anticipated experience will change. Now, remember, these are not participating contracts. So, we are not talking about modifying to reflect past experience. We are not talking about the contribution principle which was essential to the determination of dividends in participating policies. We are talking about modifying future charges or future benefits to account for what we anticipate is likely to happen in the future.

Another example is a policy to adjust the variable or the indeterminate elements in a contract to reflect only anticipated adverse experience. That is:

"We'll keep the profit, but if we think it's going to get worse, we're going to charge the policyholders for that." That can be a company policy, although there are those who say that's not acceptable.

Some contracts are designed with the notion of attaining, and maintaining, a certain competitive attitude with regard to similar contracts of other companies or, perhaps, with other contracts within your own company.

These are policies which a company may establish at the time a contract is first developed and which are the guidelines under which the actuary determines and redetermines pricing and benefit structures as the policy experience develops. There is also, we feel, a need to consider the company's operating practices in relating redetermination policies to profit or marketing policies. How is the company going to monitor this, and has the company established certain rules in order to accommodate this?

Recommendation 2 says that the actuary's report to management should include a description of the policy and of the various features of the policy under which this advice is given, and should include a definition of areas which are incomplete in stated company policy and in which the actuary has made assumptions about what that policy should be.

Recommendation 3, then, says that the actuary's report should include a description of the special operating practices that might affect the future repricing and how a description of the monitoring system is established to ensure that these practices are followed, or to document when they are varied.

Section 4 the actuary's report, generally, is separate for each contract class. Section 4.2 lists five elements which might be used in defining a class. Contracts should be of a similar type. They should have the same structure of charges and/or benefits, and each class should have the same sets of anticipated experience factors or bases for factors -- for example, the mortality table on which the anticipated mortality is based. They should be issued over a continuous time period, and they should have similar marketing objectives. Usually, a contract is not changed from one class to another after it has been issued.

Recommendation 4 says that the actuary's report should describe the particular contract classes which are involved and which are covered by this report. If there have been any changes in the assignment of contracts from one class to another, they should be identified, and the reasons for making those changes should be defined. In Section 4.5, we go into defining what contract factors are. Those of you who are familiar with the dividends reports are familiar with that. Recommendation 5 says you should identify the contract factors.

Anticipated experience factors are also covered in this section, and Recommendation 6 says that these should be described in detail, with particular emphasis on any changes which are going to be made, or which we are advising our management to make.

The process which leads to a formulation will undoubtedly include approximations, modelling, and so forth. The formulation itself may not reflect your formula for the premium and will not reflect every anticipated experience factor, specifically. Your management needs to know what those factors are in order to make a reasonable decision, and your management needs to know where you made approximations, and did your modelling. That's Recommendation 7.

Section 5 covers the actuary's advice. Recommendation 8 states that the report should include specific advice regarding charges and benefits, and identify any changes from prior reports and explain any reasons for the changes.

Recommendation 9 calls for stating how well the advised benefits and charges comply with the company Policy which has already been described in the report as is understood by the actuary. It should certainly outline where the advised benefits and charges do not comply with the company policy as it existed prior to these recommendations.

Recommendation 10 calls for inclusion of sensitivity test results in the report. In particular, we are all aware of the changes in interest rates these days, and certainly, some sensitivity results in this area are advisable, and the actuary should reveal to the company management exactly what might happen. Perhaps he's not the best person to prognosticate what's going to happen as far as interest rates are concerned, but he certainly can predict what will happen

within a range of variations. That's only one example of a sensitivity test that would be appropriate. It's the same with respect to expenses and mortality. Morbidity experience would also be appropriate.

Section 6 deals with regulatory and other matters, and Recommendation 11 is the caveat that we must be aware of what the regulators are going to expect from us and that we have to operate within the legal framework.

In summary, there's a lot of uncertainty about future developments in this area. For that reason, we have left considerable flexibility in this exposure draft. As time goes on and we learn of what develops in the future, we may be able to be more specific. Most certainly, now, the actuary has to have as much leeway as possible in exercising her or his innovative capabilities in developing these policies, and in reacting to circumstances which will change in the future.

In keeping with that philosophy, we have one Interpretation, which I think has been suggested is a cop-out on our part. It has to do with recouping past losses, or distributing past gains. It's not something that we agreed on the first time we talked about it. One important element is the extent to which accumulated losses or gains will be allowed to affect the redetermination. Our conclusion was, in this Interpretation, that a specific provision for recovery of past losses or distribution of past gains in the redetermination of non-guaranteed charges or benefits is also a possible element of a company's policy. The actuary's report should specifically describe the policy. In this regard, we have said that the recovery of acquisition expense through annual amortization is not considered recovery of past losses. That should be built into your pricing originally. And, again, the caveat that whatever you do in this area is also subject to regulatory oversight.

MR. TOZER: We are talking about non-guaranteed elements. This is not confined to one of the products that was popular several years ago in which premiums might be on a non-guaranteed premium scale or the premium scale might be fixed but the benefits could be changed. This applies to products which have any type of non-guaranteed element, except dividends. Consequently, we are talking about Universal Life which has non-guaranteed cost of insurance

factors, a non-guaranteed interest rate, and may have a non-guaranteed expense element. We are also talking about many term products which have a non-guaranteed current premium. I think a majority of the products that are being sold today would fall under this set of recommendations.

The second comment is that we have used the word actuarial "advice." Pricing and repricing, we feel, is a management prerogative. We think that to say that the actuary has the responsibility to tell and enforce management to do certain pricing is unrealistic. The actuary can give advice to management, but we feel management, is going to do what it thinks is best for the corporation. As a result, we are asking that the actuary give good advice to those people making the decisions, but we do not feel it is the actuary's role to be a whistle blower after management makes that decision, or try to tell the management, "You can't make that decision."

Also, I'd like to point out a question which we debated in the committee and about which we are interested in further input. What is the actuary's role in relationship to the sales illustrations the company may be putting out? Is what is being implied in those sales illustrations of concern to the actuary? Does he have a responsibility, for example, to react if the company is illustrating 15% interest and he expects it to be very difficult for the company to actually be able to deliver on those illustrations?

We welcome comments on the exposure draft or on the work of the Subcommittee itself. Also, I'm sure John would welcome any comments you have on the IASB or on the work the IASB is doing.

MR. ALAN W. SIBIGTROTH: I am a management consultant in my own business, and I see a number of areas where we face potential problems. We've discussed some of the examples. We make recommendations to management, only some of which are implemented. We are representing, in some cases, that products comply with regulatory, SEC, and perhaps tax qualification standards. We also advise management as to the financial evaluation of its businesses under a variety of different climates -- which may or may not emerge. As a practicing professional, I'm interested in what role we can play to help work within the

forum and to understand the boundaries within which the actuary is supposed to practice under this new board.

I'm also president of the New York Actuaries Group, and we are interested to know how the regional organizations might help to codify standards and practices. We are getting pushed in some directions by the Academy, and it would be of interest to know what is the forum, or anticipated forum, within which we can have a communication between us as professionals and the Actuarial Standards Board.

MR. FIBIGER: There are going to be times, and certainly a number of pension actuaries feel they have already come, in which actuaries will have to comply with regulatory standards and do things that fall beyond the scope of normal actuarial practice. For example, there are clearly some populations for which the actuarial cost method mandated in FAS87 is not appropriate other than for producing a particular number, required for a financial statement of the plan sponsor, to be be in compliance with GAAP.

In those instances, what we expect is to have a three level hierarchy. The first would be general principles. They would, we hope, cross lines of practice and would be, in effect, universal fundamental truths, known by all actuarial practitioners. Just the codification of those principles in the area of valuation of life insurance company liabilities has proven to be quite a chore. An example is the question of discounting, as I have already pointed out. The second level would be standards of actuarial practice. For example, in valuing a pension plan, you obviously have to take mortality into account regardless of the purpose of the report.

The third is what we call compliance requirements. In some situations, there are people who really don't understand what they have mandated, whether it be regulators, accountants, or government bodies. To the extent that you have to comply, you should make it clear that you are only reporting for a particular purpose. If you submit an actuarial report, it should be made clear to whomever you are doing the work for, that it is a very narrow compliance requirement which you are meeting. To the extent that good actuarial practice would call, in your judgment, for you to use another method or show additional data, we

expect that it will be the requirement of the professional to not only comply with the requirement but also to caution that this information should not be used for other purposes.

In respect to the local actuarial clubs, we have not yet established a permanent relationship. On an interim basis, we are trying to see if we can develop standards and procedures which can be promulgated to and dealt with by the profession. Certainly, I would think that use of local clubs would be one of the mechanisms. Anytime anyone wants to communicate with the Actuarial Standards Board, he can merely write to the board in care of the Academy office in Washington to the attention of Eleanor Mower, who is the Academy staffer dealing with this. Again, as I said before, I think the FASB goes overboard in trying to hold too many public hearings. However, we certainly do want this to be open to anyone. So if, for example, an Actuarial Club wanted to set up a separate committee within the club to review any standards, and if the club wanted to make a regular practice of commenting on the standards, we would welcome that. The idea is not to freeze anybody out. I think you've seen in this particular standard that it isn't to mandate one particular accepted level of practice. It is merely to say that there are a number of things that should be considered both in doing the work and in reporting it.

MR. SIBIGTROTH: What kind of guidance would you give an individual who is in an area of emerging actuarial practice -- one that's not well defined or perhaps not employed by a large number of colleagues? Is there any guidance that you can offer?

MR. FIBIGER: My guidance would be, first of all, to read the guides for professional conduct. I would really stress that because, I think, people working in emerging areas often do try to practice beyond the scope of their ability.

One of the purposes of the standards is to provide sort of a track to run on, so, as we hope with the continuing care retirement communities standard, there will be a list of things the actuary should consider. I would suggest that when you're faced with a problem for which there isn't any literature, do your best to read the other literature and consider whether a particular technique

or consideration might be extended to an area of practice in which you are unfamiliar. One problem is with the unavailability of data, and for that there really isn't anything to say except use your professional judgment and remember any considerations that do not apply in the particular situation. For example, a body of data obtained on guaranteed issue life insurance where the maximum amount was $10,000 probably wouldn't apply if the maximum amount is $500,000. Consider the source of the data. Secondly, consider the techniques for applying and manipulating that data and be sure you do as wide a literature search through other standards already in existence as possible.

MR. JOHN H. HARDING: You mentioned earlier that there has been specific disclosure in Schedule M on previous portions of the work done by the Subcommittee. Do you anticipate proposing any such disclosure, consistent with this draft?

MR. KEMBLE: We are prepared to respond to a request for this sort of a disclosure document. In fact, we have done some work in outlining what we think such a document should contain. We decided not to include it with this exposure draft because we had hoped to get considerable discussion, and we weren't sure what form it might take. Further, I don't think the NAIC has yet acted on the Schedule M modifications in their entirety, and we didn't want to confuse the issue by adding this. It's in our minds.

MR. HARDING: It would be in the front of my mind simply because of what Dick Stenson mentioned earlier and is attributed to Walt Miller as the "vacuum." The very broad permissive nature of the statement of redetermination policy leaves us in a position with almost nothing there, unless there is public disclosure, so that there is some basis for the public to understand what in fact you are doing.

MR. TOZER: I just want to echo what Jim said. We've had a lot of discussion in this area, but we are first attacking the communication between the actuary and company management, and we felt that to also get into an area of communication with the regulator was a little difficult to handle until we completed step one. We have been, at least informally, approached by John Montgomery about the need for disclosure to the regulators.

MR. JAMES F. REISKYTL: I'd like to pick up on that point. Will disclosure be limited to the regulator, or do you intend to give anything to the consumer? We have so many different pricing practices in existence today, but the consumer has no idea which pricing practices are being followed. In fact, in your one example, perhaps the company doesn't know what its pricing policy is, which is even more disturbing. How can the buyer have any idea what he has purchased? Is there any interest in requiring in the contract that there be some disclosure of what the practice will be in repricing and what the basic pricing practices will be?

MR. KEMBLE: We did raise that question in our cover letter. We asked that the membership give us some guidance in this area. I believe that the actuary can't just let the responsibility drop. I think it's a question that we need to discuss much more thoroughly. I for one think that what the actuary writes to the company management is not in its entirety the business of the public, or the individual consumer. We agreed upon that a long time ago when we were discussing dividends. There are certain elements of a company's dividends, certainly of the basic underlying factors, and there are elements of our anticipated experience factors in this sort of a product that really are proprietary, and they are not the sort of thing which needs to be disclosed to the public. What needs to be disclosed to the public is: "We told you this is what we were going to do, and we are continuing to do it. Or, for certain reasons, we are not able to continue to do it, and here is what we are now doing and will do in the future."

MR. TOZER: Dick, would you like to make any additional comments? I think this is an important question.

MR. STENSON: It's a very important question. It's going to require some more evolution and thinking, even more so than was the case with dividends, because we don't have the underlying background, legislation and perception on it. These are non-participating policies even though they have declared elements from time to time. But if you operate in New York, there is a clear standard in terms of redetermination that you have to abide by -- that there's basically no change in prospective expectation of profit when you make a

change. So that's in the background. We'd appreciate any other comments as to what people think about this.

MR. FIBIGER: This applies not only to the dividend approach but also to some of the things the valuation actuary committees are wrestling with. There is rather strong sensitivity on the part of people representing company management that it is appropriate for actuaries to determine standards for their own profession, but that it is not necessarily appropriate for the actuary of the company to regulate upward. There should be a separation between actuarial reporting standards and regulatory standards. Regulatory standards should be left to the process by which they are determined by the regulators and by state insurance laws. It is this potential usurping of the management prerogative that produces a lot of sensitivity. You have to have some ability to be proprietary.

The two things that may lead to further publicity beyond the actuarial standards would be either regulation or competition. If one company feels it has a superior method, whether it is determining dividends or redetermining some of the rates we are discussing today, they may well want to try to take a competitive advantage from it. But I think trying to have this done by actuarial standards, rather than by either of the forces of competition or regulation, would probably run into a tremendous amount of resistance on the part of other people in company management.

MR. TOZER: I think everyone on the Subcommittee feels that this is a very important issue. If the Subcommittee were to do anything in this area, it would probably not say that a company should or shouldn't do something, but instead that certain disclosure should be made to enable the buyer to understand what's involved. I doubt if the Subcommittee does anything that will go beyond making sure that the buyer has adequate information. That is only an interpretation of some very general discussion at this stage of development, and I wouldn't want to imply that that is what the Subcommittee is going to do. As John points out, we see this as being a very sensitive issue.

MR. OWEN A. REED: On the disclosure question, it seems to me to be clearly an industry matter. That is to say, the ACLI is going to have a lot

more to do with it than the actuarial professionals, and it seems to me that what the actuarial body should do is pass its views on to the ACLI, and hopefully get something done. I think that would be quite a hurdle personally.

I have a feeling that people, through reading these draft recommendations, would infer that every time a redetermination is done, an actuarial report is going to be written. That, of course, is far from the truth for products such as SPDAs and so on where you have committees of people sitting around each week, and the committee decides on what the rate is going to be and so on. I think there should be some clarification up front that this is somewhat restricted in its application. Also, there's no objection to having solvency objectives mentioned in the exposure draft, but really I don't know what that means.

MR. REISKYTL: This is a question for John relative to the Standards Board and is related to my prior comments. How does the Standards Board go about its process? Where are the actuarial principles from which standards derive, or do standards begin the process and lead to principles? Would you give us some comments from your perspective on the difference between principles and standards, and how you are going about this process?

MR. FIBIGER: We are going about the process by trying to identify, first of all, where we are. It becomes readily apparent that, in many cases, the Principles, that is the universal truths that apply regardless of the practicality of the situation, are pretty hard to extract. I know the Society Committee on Valuation Principles wrestled for over a year with these. We are finding the same thing across the actuarial profession, such as do you use discounting or don't you use discounting? Where do you factor in probabilities and where don't you? At what level do you ignore things as being *de minimus*? Do you adopt principles, such as the accountants have, of materiality? If so, how do you define materiality? Many things like that. We are just beginning our search to identify those areas where we do need principles developed. We have talked about even commissioning some studies, in particular to look at all of the actuarial literature available, especially in the study material of the various actuarial bodies, to see what can be extracted from that. A trained university researcher with interest in actuarial work might

extract from the study material certain fundamental principles that seem to apply across all lines. Do we have to say that here's a fundamental principle that applies only a limited portion of the time? We're still wrestling with that. I can't tell you how it's going to come out. It was just at our last meeting that we had a very educational discussion, I think, for many people coming from the different disciplines, of why certain things are done one way by casualty actuaries and another way by pension actuaries and perhaps even a third way by life actuaries. We are going to do our best to extract these common principles. I think if a valuation of a liability can vary by as much as 20%, just as in my example of the structured settlement, which is handled by both life and casualty companies, maybe we are not as much a profession as we thought we were. One of the things that we need to do is identify what principles are being followed. That, obviously, involves going back through and looking at the existing literature. Another way is to have one of the constituent bodies, if it is willing to do it, work on the principles. If not, we will have to look elsewhere -- perhaps commission a study, or ask some of the actuarial education and research foundations if they can commission someone to do it.

We are trying to deal more with the public interface area -- what the actuary does in the practical situation of dealing with clients, with the public and so forth. We have long wavered, particularly in non-public activities, between being a society of highly trained employees and a society of professionals with a body of principles and standards of practice. As of now, we have discovered there is less commonality than I as a professional feel comfortable with. It also gets mixed up with the regulatory question. To what extent can we control the way in which our data are used, or abused, by the people to whom our reports are made?