

RECORD OF SOCIETY OF ACTUARIES 1989 VOL. 15 NO. 3A

FINANCIAL REPORTING SECTION -- CURRENT TOPICS IN THE UNITED STATES

Moderator: STEVEN A. SMITH
Panelists: HAROLD G. INGRAHAM, JR.
W. HAROLD PHILLIPS
DONALD R. SONDERGELD
ROBERT W. STEIN
Recorder: STEVEN A. SMITH

- o The Financial Reporting Section meeting will include a short business meeting of the section, followed by an open forum covering:
 - Update on revision of standard valuation law and MSVR -- Tweedie Committee
 - Actuarial Standards Board
 - Cash flow testing
 - Reinsurance reporting
 - GAAP
 - AIDS reserving
 - Appraisals
 - NAIC
 - FASB
 - Emerging Issues Task Force
 - AICPA
 - COVARA

MR. STEVEN A. SMITH: Until the end of the annual Society meeting, I am still Chairman of the Financial Reporting Section Council. This is the breakfast meeting of the Section. We will have a short business meeting during which time I will bring you up to date with what has been going on in the Section during the last year. Then we have a fine panel of speakers and hope to cover all of the topics on the program. At the end of the annual meeting or sometime during it, I will be replaced by Glen Gammill, who is the incoming chairman of the Section Council.

The Financial Reporting Section was organized in October 1982, with the purpose of encouraging and facilitating professional development of its members through meetings, seminars, research and publications. The Section Council has, through the last seven years, taken the lead in achieving this purpose by developing programs for annual and Spring specialty meetings, selecting and proposing seminars and resources projects, and publishing a newsletter as well as incidental papers.

The importance that the Council has placed on program development and content is best evidenced by the fact that for at least the last three years when I have been on the Council, I think longer than that, council meeting dates have been arranged to coincide closely with the needs of the Section and Society Program Committees. Every Council meeting has had as a major agenda item, and often one of the most important agenda items, the development of program topics and/or the organization of the recruiting effort for Society sessions that we are sponsoring.

While we have a good program committee, the input of the Council members, who were presumably elected to the position because of their knowledge and expertise, is viewed as essential to the development of quality program sessions. We believe that this view has substantially contributed to the strong and usually very well attended and enjoyed sessions sponsored by the Section. During 1989, the Section sponsored a major portion of the Vancouver meeting and will have a significant participation in the New York meeting. Members of the Council also made significant contributions to the planning of the successful 1989 Valuation Actuary Symposium.

One of the most significant developments for the 1988-1989 year was the improvement of the Section's newsletter to the point that it is now viewed as the model for section newsletters. We

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owe a lot of thanks to Ed Jarrett and his editorial staff for a job that has been extremely well done.

At the end of 1988, the Section sponsored and underwrote the publication of Dave Holland's AIDS paper, which was then distributed to Section members free of charge in time for potential use in calculating year-end reserves. During the summer of 1989, the Section underwrote the publication of two additional papers on AIDS: 1) the report of the Committee on HIV Research entitled "U.S. General Population Projected AIDS Mortality Rates," and 2) the report of the Task Force on the Financial Implications of AIDS entitled "The Financial Implication of AIDS for Life Insurance Companies in the United States." Both of the latter papers have been submitted to the Actuarial Standards Board (ASB) as a potential basis for a standard on the subject. We will hear more about that later.

During the 1988-1989 year, membership in the Section increased substantially from about 1,850 members to roughly 2,350 members. That is about all that I had at this point on the business of the Section. We have a reasonable amount in the treasury to fund the projects that we are undertaking, so I don't see any financial problems.

Before I introduce the rest of the panelists and get them started, there is one topic that I am going to discuss myself, namely, NAIC Guideline XXX, because I am a member of the American Council of Life Insurance (ACLI) Committee that is working on trying to develop an alternative to it.

I guess the "XXX" nomenclature came about by accident and has kind of stuck. NAIC guidelines have Roman numerals as their numbers. "XXX" was originally intended to mean just an unnumbered guideline. I think the last one was something like XXIV. If it is passed, however, it will be renumbered.

Guideline XXX is a proposed NAIC actuarial Guideline intended to update NAIC Guideline IV. Any company in the term market should be well aware of XXX.

NAIC Guideline IV prohibits the use of the unitary policy reserve approach. It applies basically to increasing premium term policies that do not have cash values and are valued on the 1958 CSO basis. Guideline IV requires that reserves for such policies be calculated on a period-by-period basis, with each period being the time during which premiums are level. Additional reserves must be held for each future period in which net premiums exceed gross premiums. The NAIC's Life and Health Actuarial Task Force (LHATF) is proposing to increase the coverage of Guideline IV by including, through Guideline XXX, 1980 CSO plans and all plans, term or not, that have no cash values in the first ten years. XXX, as it is currently proposed, would apply immediately to all inforce business with no phase-in period for existing business. In my opinion, this could make a few companies retroactively insolvent. It is not a small thing or potentially a small problem.

At the June LHATF meeting, the ACLI and National Association of Life Companies (NALC) volunteered to set up an Industry Task Force to address the regulators' concerns about reserve adequacy on the plans that XXX would cover. The ACLI/NALC Committee is chaired by Reed Miller of Lincoln National and he made an interim report to LHATF at its October 5th meeting in San Francisco. This report involved comparisons of Guideline XXX reserves to natural reserves or GAAP reserves for a number of typical plans that would be covered by the proposed Guideline XXX. The ACLI Committee is not recommending the use of natural or GAAP reserves as a statutory basis, but rather it is recommending it as a baseline standard against which it can test alternative solutions or proposals as it comes up with them.

The conclusions from the comparisons that were made are not always obvious, but, for at least some plans, I feel pretty strongly that the comparisons that were developed by the Committee indicate that XXX produces reserves that are many times what is needed. The ACLI Task Force indicated that it needs more time to develop recommendations. Guideline XXX is going to be discussed further at the next LHATF meeting on December 2, 1989 in Las Vegas.

Now I'll offer a personal view, which may be wrong. I don't think that Guideline XXX will be adopted this December for use in 1989 statements. I do have hopes that we will be able to come up with a reasonable alternative that will be acceptable to the regulators, the companies and everyone concerned.

FINANCIAL REPORTING SECTION -- CURRENT TOPICS IN THE UNITED STATES

Now I am going to introduce Don Sondergeld, who spent 25 years as the Chief Actuary at Hartford Life and is currently the Executive Vice President and Chief Financial Officer of Mutual Benefit Life. He is going to pinch hit for John Tweedie and give us a report on the revisions of the Standard Valuation Law and the Mandatory Securities Valuation Reserve (MSVR).

MR. DONALD R. SONDERGELD: As Steve has indicated, John Tweedie is head Chairman of the NAIC LHATF Advisory Committee. (John had a board meeting and felt that he should be there rather than at this meeting.) Let me give you a little background. The NAIC LHATF has had a number of Advisory Committees advising them regarding possible changes in the Standard Valuation Law.

John Montgomery, Chairman of the NAIC LHATF, appointed the current Special Advisory Committee with the following charge:

The Committee will develop a draft of a model law and accompanying regulations that would require each company to submit an acceptable opinion by a qualified actuary, supported by an appropriate memorandum describing the basis of such opinion, as to the adequacy of certain specified reserves, and the assets supporting such reserves. (Sounds like a legal charge in one sentence.) This draft will be available for discussion in May 1989.

This Special Advisory Committee, on which I served, is referred to as the Tweedie Committee, as John Tweedie, Senior Vice President and Chief Actuary at Metropolitan Life, is its Chairman. In addition, Dick Minck, of the ACLI, and Roy Woodall, of the NAIC, provided input on the views of a broader group of companies -- particularly smaller companies. Also, appropriate committees of the AAA and the SOA were kept informed of our deliberations.

The Tweedie Committee's thinking was expressed to the public in many forms. These included presentations at meetings of the SOA in June and October 1988 and the Valuation Actuary Symposium in September 1988. A preliminary report was given to the NAIC LHATF in December 1988 and to the Board of Directors of the AAA in December of that same year. The ACLI also sent copies of this preliminary report to its membership in January 1989.

In addition, the Life Committee of the ASB, of which Harold Ingraham is Chairman, has been observing the progress being made and has begun developing standards of practice.

A "final" report of the Tweedie Committee was submitted to the NAIC LHATF at its June 2, 1989 meeting. It was then approved by the NAIC for exposure the following week. There is no intention that the recommendations will be acted on at the December 1989 meeting. It is more likely that they will be adopted at the June 1990 NAIC meeting and perhaps the odds are only 50/50 at best for adoption then. Although I will come back to this, let me now tell you what was in the Tweedie Report.

The charge to the Tweedie Committee and the focus of its report is an effort to make more meaningful the role of the actuary with respect to the valuation process, in particular the adequacy of reserves, and the assets that support them, as reported in the statutory Annual Statement Blank. The Tweedie Committee's recommendations relate to certain changes in the Standard Valuation Law and include additional regulations.

Let me comment on three items: 1) the appointment of a valuation actuary, which, in New York's Regulation 126, is referred to as a Qualified Actuary; 2) the opinion on the adequacy of the statutory reserves; and 3) the confidential report to management that documents the actuarial work supporting the opinion.

APPOINTMENT OF A VALUATION ACTUARY

He or she must be officially appointed within a structured protocol.

The valuation actuary must be a Member of the AAA. This is to provide a professional discipline basis for use by regulators, clients and peers.

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The valuation actuary must meet qualification standards of the AAA and must attest to such standards in the opinion.

ACTUARIAL OPINION ON RESERVE ADEQUACY

The valuation actuary must provide an opinion on the reserve in the annual statement and the assets supporting them.

A qualified opinion must be so stated in a structured manner.

In executing the work in preparation of the opinion, the valuation actuary must follow the standards of practice promulgated by the ASB.

The valuation actuary can only be held liable to management and to the regulators.

The actuarial opinion is with respect to the adequacy of reserves and supporting assets, not on current or future company solvency, per se.

The suggested framework for the standards of practice is structured to assume the ultimate test is a multi-scenario cash flow test, but it provides bases on which a cash flow test would not be necessary.

The proposed Regulation specifically provides for opportunity for the NAIC to define a basis for small companies to be exempt from certain aspects of the opinion regulation.

The reserves are not presumed to cover catastrophes, rather reasonable deviations in experience.

A full-blown revision of the MSVR is not included as a part of this proposal. However, a limited modification to the MSVR is recommended, which in certain cases would permit a reduction in the MSVR to help set up additional reserves. The more comprehensive changes that the Committee believes deserve further consideration are discussed in an Appendix so that it is not lost with respect to the efforts of others who are addressing the issue of the MSVR's future.

CONFIDENTIAL REPORT TO MANAGEMENT

The valuation actuary must prepare a Memorandum for management documenting the work that supports the opinion.

The valuation actuary's Memorandum is prepared for the company and confidentiality at the company's discretion is provided by the proposed law, except where the Academy needs it for the disciplinary process, or it is required in defense of a lawsuit.

The Memorandum is available within the scope of confidentiality to the regulator.

If the valuation actuary's Memorandum fails to meet the standards provided by the Regulations, the Insurance Commissioner may engage a qualified actuary at the expense of the company to review the opinion and prepare a Memorandum required by the Commissioner.

Let me now bring you up to date on two recent developments. They are a September 15, 1989 letter from the ACLI and NALC to the NAIC LHATF, and the September 1989 meeting of the NAIC LHATF.

ACLI AND NALC LETTER OF SEPTEMBER 15, 1989

This letter dealt with the "Smaller Company Considerations" of the Tweedie Committee report. The letter recommended that:

1. Companies with less than \$20 million in assets be exempt from the regulation.
2. Companies with \$20-100 million in assets would be exempt from the regulation subject to meeting specified limitations as to growth and product mix -- provided there has not been a change in control of the company during the current year.

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3. Companies with \$100-500 million in assets would need to furnish an opinion only every three years provided the limitations applicable to companies with \$20-\$100 million of assets are met.

NAIC LHATF MEETING SEPTEMBER 1989

At this meeting there was a discussion of the Tweedie Committee report. At least four items should be mentioned:

1. **Health:** The proposed regulation includes Health -- yet many states do not have Health Valuation laws. This needs to be addressed.
2. **Confidentiality:** There are regulatory concerns regarding the need to make the actuary's entire report confidential.
3. **Qualified Actuary:** There is the question of whether the Valuation Actuary must be a Member of the AAA, as some states are currently relying on nonmembers of the AAA.
4. **Discipline:** The NAIC believes it has a responsibility for disciplining the valuation actuary, rather than relying on the Academy for discipline.

Larry Gorski, Life Actuary for the Illinois Department of Insurance, and Bob Callahan, Chief of the Actuarial Valuation Bureau of the New York State Insurance Department, were jointly given the charge at the September meeting of the NAIC LHATF to come up with a revised draft that would address the concerns that I just mentioned. This revised draft would then be discussed at the December 1989 meeting of the Task Force and the earliest the revised draft would be recommended for adoption would be June 1990 -- but December 1990 might be more likely.

MR. SMITH: Our next speaker is Harold Ingraham, who is currently Vice President of the Hartford office of Tillinghast/Towers Perrin. Previously he was Senior Vice President and Chief Actuary of New England Mutual. He also is Chairman of the Life Committee of the ASB and past President of the SOA. Harold is going to cover the present and upcoming standards of the Board which are cash flow testing, reinsurance reporting, GAAP, AIDS, and appraisals of companies.

MR. HAROLD G. INGRAHAM, JR.: Before briefly discussing some of recent standards of actuarial practice produced by the ASB or ASB's Life Committee, let me just say a few words about the ASB itself. The reason I want to do that is because I think many actuaries unfortunately are still unfamiliar with what the ASB does, what it stands for, what its true nature is, and so forth.

The ASB is an independent entity operating within the Academy. The ASB has sole responsibility to initiate the development of, and to adopt, new standards. As a general rule, standards are developed by the operating committees. But ASB procedures also allow for special cases in which another committee or an ad hoc task force may be appointed with the specific charge of drafting or updating a standard. In my own committee's case, we rely very heavily on the Academy's Committee on Life Insurance Financial Reporting headed by Paul Kolkman, who is also on the Life Committee of the ASB.

The ASB has made it plain that it won't permit the setting of rigid standards. They believe that standards of practice must be conceptualized and worded in such a way that they do not unnecessarily circumscribe an actuary's creativity in approaching new problems. In other words, the ASB endorses the "disclosed defensible deviation" approach. And the ASB has instructed its operating committees "to avoid being overly prescriptive and to allow the actuary to deviate when he has justification."

The Life Committee is one of seven ASB operating committees. Prior to this year, it produced two standards which have been adopted:

1. In 1987, recommendations concerning the Redetermination (or Determination) of Non-Guaranteed Charges and/or Benefits for Life Insurance and Annuity Contracts.
2. In 1988, a standard on How to Do Cash Flow Testing for Life and Health Insurance Companies.

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Two more of the Life Committee's standards were adopted this past August.

One involved the Treatment of Reinsurance Transactions in Life Insurance Company Financial Statements. This standard is intended to cover the work of both ceding company and assuming company actuaries in preparing statutory and GAAP financial containing material reinsurance transactions.

This standard requires the valuation actuary to understand material reinsurance contracts and make judgments about their impact on reserves. Under the standard, the final test of reinsurance credit is that the resulting net liability makes appropriate provision according to the best estimate of future experience.

The standard provides that a reinsurer may hold a reserve that is more or less than the reserve credit taken by a ceding company. This means that mirror reserving is not required by the standard.

The standard notes that, under certain circumstances, an actuary may undertake to confirm sufficiency of net statement liabilities through the use of cash flow testing. Such circumstances might include material reinsurance transactions, partial or nonproportional benefit reimbursements, or instances in which treaty structures don't parallel the original coverage.

The standard states that an actuary should consider non-actuarial items, such as reinsurance receivable assets, when making judgments about the sufficiency of net statement liabilities.

Also, before taking any reserve credit, the standard requires the actuary to consider the financial condition of the reinsurer to determine that reinsurance recoverables are likely to be collected.

The second standard adopted in August is entitled "Methods and Assumptions for Use in Stock Life Insurance Company Financial Statements Prepared in Accordance with GAAP." That standard sets out the considerations that bear on an actuary's professional work in the determination of policy benefit liabilities and deferred policy acquisition cost (DPAC) assets in accordance with GAAP accounting. The impetus for developing this standard was the promulgation in 1987 of FAS Statement No. 97 and the need to update existing Academy Recommendations and Interpretations. As most of you know, among other things, Statement No. 97 established GAAP for universal life and other insurance contracts not specifically addressed by Statement No. 60.

This standard distinguishes between two categories of actuarial assumptions principally used in the preparation of GAAP financial statements: "best-estimate" assumptions which must be periodically updated to reflect current experience, and assumptions with provision for risk of adverse deviation which are subject to "lock-in" under Statement No. 60.

The standard states that best-estimate assumptions should be internally consistent and should reflect the actuary's judgment at each valuation date as to the most likely future outcome with respect to each assumption made. It notes that assumptions that include provisions for the risk of adverse deviation should bear a reasonable relationship to the best-estimate assumptions.

The standard calls for regular reviews of the adequacy of the net GAAP liability when experience indicates that the recognition of loss may be required.

At their meeting earlier this month, the ASB approved two additional draft standards for exposure to the Academy membership. One proposed standard provides guidance to the actuary in deciding Whether or Not to Perform Cash Flow Testing when giving a professional opinion or recommendation for a life or health insurance company. The Tweedie Committee report has set forth a basis and framework for development of standards as to when to do cash flow testing related to statutory reserves. This standard builds on that report and also provides expanded guidance for when to do cash flow testing in areas other than testing of reserves.

This is a particularly timely standard in the light of developments in recent years. With the large increase in the level and volatility of interest rates beginning in the early 1980s, the advent of the AIDS epidemic, group underwriting losses, the increased default risk associated with below-investment grade bonds, and the development of interest-sensitive insurance and annuity products -- it has become apparent that cash flow testing needs to be both sophisticated and more frequent.

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This proposed standard notes that the need for testing depends on the nature of the risk. Also, the type and depth of the actuary's cash flow testing analysis should relate to the type and severity of the asset and liability risks. For example, in the case of a mature block of business which over time has proven itself to be relatively insensitive to changes in economic conditions, an actuary may determine that cash flow testing is not needed to support the opinion or recommendation given.

The use of prior cash flow studies may be acceptable. The standard requires, however, that when relying on prior work, an actuary should be assured that emerging experience is within the range of expected results and that the key assumptions in the study have not changed materially since the prior study was performed.

The standard concludes that there are practical limitations on the amount of cash flow testing needed to support an actuarial opinion or recommendation. On the other hand, the standard requires the actuary to be prepared to explain (in a report or otherwise) whether or not cash flow testing was done -- and, if not done, why not.

The second exposure draft relates to Estimating and Providing the Cost of HIV-Related Claims. Because little guidance has been available to actuaries in estimating and providing for extra claims resulting from human immunodeficiency virus (HIV) infection, a standard of practice here is urgently needed.

This standard notes that the margins in statutory reserves historically have not been set at levels intended to cover the excess mortality and/or morbidity resulting from epidemics of sudden impact and short duration, such as the influenza epidemic of 1918-1919. In those instances, a combination of dividend reductions and surplus allocations served to cover the risk. However, this approach is inappropriate in the case of the AIDS epidemic because of its magnitude and potentially long-term nature.

This standard states that the valuation actuary should demonstrate either that reserves contain adequate provision for the cost of claims related to HIV infection or that any excess claims cost not so covered is provided for by an allocation of surplus or other adjustments. If cash flow testing indicates that reserves should be increased in the actuary's judgment, then reserves should be increased directly. This means that an allocation of surplus alone would not be sufficient.

The standard states that a valuation actuary should prepare a report documenting the assumptions made with respect to the extent of HIV infection associated with his or her company's blocks of business being valued and projections of HIV-related claims expected to be paid. If additional reserves are not established after such projections are made by the valuation actuary, the reasons for not doing so should be fully documented.

This standard also reminds the actuary to recognize that lapse rates for the infected insured population will be significantly lower than the corresponding lapse rates for the uninfected population. This, of course, means that projections of future HIV-related claims could be seriously understated unless this lapse differential is taken into account and appropriate reserving techniques are used.

Both of these important exposure drafts will affect regulators and all actuaries establishing reserves for life insurance financial statements. Accordingly, I urge all of you to review them if they are applicable to your actuarial practice and to submit written responses during the comment period which will last until next February 15. This is a sad commentary, I think, on the membership. We have 8,000 members of the Academy. We never get more than 25 or 35 responses when we send out a standard for exposure.

Another important standard on actuarial appraisals is being developed by a special risk task force chaired by Bob Shapiro. This is a diverse and eclectic task force -- consisting of life and property and casualty (P&C) actuaries, actuaries in consulting and actuaries in accounting firms, plus two investment bankers who are not actuaries. The task force's charge is as follows:

To develop standards for actuarial appraisals and/or analyses which provide consistency between life insurance and casualty insurance situations. The standards shall provide guidance to developers and users of such actuarial reports, leaving room for variation

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within items that differ between life and casualty work. Thus, these standards will deal with those issues that are universal to appraisals of insurers and other related organizations.

A vital purpose of this proposed standard is to have it play a strong role in maintaining a high level of market credibility for actuaries working in areas of actuarial appraisals and mergers/acquisitions.

Some of the questions being addressed by the Shapiro task force are the following:

- o What is the minimum level of actuarial attention and analysis required for an actuarial appraisal?
- o What levels of communications, documentation, and disclosure should be reported for these work products?
- o What (or who) is the intended audience for this standard?

Not surprisingly, it is hard to get your arms around this and there are many diverse opinions that are being given in the discussions that the task forces have.

This standard is being developed under the joint aegis of the ASB Life and ASB Casualty Committees. We hope to bring it to the ASB this January for approval to circulate as an exposure draft.

MR. SMITH: Our next panelist is Harold Phillips, who is a member of the California Insurance Department. He is going to bring us up to date on the doings of the NAIC Blank Task Force which met, I think, the first week of October.

MR. W. HAROLD PHILLIPS: My task is to cover some of the Life Convention Bank changes for 1989, 1990, and 1991. Awareness of these changes at an early date will enable you to plan for them and make the transition as smooth as possible. The 1989 and 1990 changes are set while the 1991 changes are in concept form. I will give some of the rationale for these changes.

LTC (LONG-TERM CARE) SUPPLEMENT

This is new with the 1989 Statement.

The column headings (line of business breakdown) for this supplement are the same as for the current Exhibit 1.

The lines attempt to gather all other items in the Blank that might contain LTC data. The total from the referenced blank location is shown, then the LTC component.

No doubt this supplement will be refined in future years. For example, we may wish to add Investment Income and Claim Reserves to the current items such as:

Premiums, Death Benefits and Disability Benefits in Part A and Reserves, Active Life Reserves and Deposits in Part B.

SCHEDULE D

Schedule D, Part 1A, Page 29B is now (1989) called "Quality Distribution of All Bonds." It will be called "Quality and Maturity Distribution of All Bonds" (Exhibit 2).

The four levels of Quality are as follows: Investment Grade; Noninvestment Grade -- Average Quality; Noninvestment Grade -- Below Average Quality; and, In or Near Default.

Additional Categorizations are as follows: C -- a demand or perpetual obligation valued at original cost, and X -- a bond rated in the top four categories by a recognized rating agency.

The maturity distribution is as follows: one year or less, 2-5 years, 6-10 years, 11-20 years, and more than 20 years.

In order to facilitate the review of changes in quality since the past year, 2 new columns are added -- 11 and 12.

LONG TERM CARE INSURANCE EXHIBIT, SUPPLEMENT TO THE DECEMBER 31, 19___ LIFE AND ACCIDENT AND HEALTH INSURANCE COMPANY, ANNUAL STATEMENT

Of the Insurance Company
 Address (City, State and Zip Code)
 NAIC Group Code NAIC Company Code

To be filed on or before March 1

	1 Total	2 Industrial Life	Ordinary			6 Credit Life* Group and Individual	Group		Accident and Health			12 Aggregate of All Other Lines of Business
			3 Life Insurance	4 Individual Annuities	5 Supplementary Contracts		7 Life Insurance	8 Annuities	9 Group	10 Credit Group & Individual	11 Other	
Part A for the Current Year												
1. Premiums and Annuity Considerations (Page 5, Item 1):												1.
1.0 Statement												1.0
1.1 Long Term Care Benefit Component												1.1
2. Annuity and Other Fund Deposits (Page 5, Item 1A):												2.
2.0 Statement												2.0
2.1 Long Term Care Benefit Component												2.1
3. Death Benefits (Page 5, Item B):												3.
3.0 Statement												3.0
3.1 Applied to Provide Long Term Care Benefits												3.1
4. Matured Endowments (Page 5, Item 9):												4.
4.0 Statement												4.0
4.1 Applied to Provide Long Term Care Benefits												4.1
5. Annuity Benefits (Page 5, Item 10):												5.
5.0 Statement												5.0
5.1 Applied to Provide Long Term Care Benefits												5.1
6. Disability Benefits and Benefits Under Accident and Health Policies (Page 5, Item 11):												6.
6.0 Statement												6.0
6.1 Long Term Care Benefit Component												6.1
7. Surrender Benefits (Page 5, Item 12):												7.
7.0 Statement												7.0
7.1 Applied to Provide Long Term Care Benefits												7.1
Part B as of December 31, Current Year												1.
1. Aggregate Reserves for Life Insurance Policies and Annuity Contracts (Page 6, Part A, Line 15):												1.0
1.0 Statement												1.0
1.2 Long Term Care Benefit Component												1.2
2. Active Life Reserves for Accident and Health Insurance Policies (Page 11, Exhibit 9, Part A, Active Life, Line 7):												2.
2.0 Statement												2.0
2.1 Long Term Care Benefit Component												2.1
3. Deposit Funds (Page 11A, Exhibit 10, Part A, Line 6):												3.
3.0 Statement												3.0
3.1 Long Term Care Benefit Component												3.1

*Business not exceeding 120 months duration

ANNUAL STATEMENT FOR THE YEAR 1990 OF THE

SCHEDULE D - PART 1A

QUALITY AND MATURITY DISTRIBUTION OF ALL BONDS OWNED DECEMBER 31, CURRENT YEAR
At Statement Values and By Major Types of Issues

1	2	3	4	5	6	7	8	9	10	11	12
Quality Rating Per the NAIC Designation	1 Year Over or Less	1 Year Over Through 5 Years	5 Years Over Through 10 Years	10 Years Through 20 Years	Over 20 Years	Total Current Year	Col. 7 as a % of Line 5.5	Totals From Col. 7 Prior Year	% From Column 8 Prior Year	Column 7 Minus Column 9	Col. 11 as a % of Line 5.5
Section 1 - Governments Schedule D (Group 1)											
1.1 YES, YES X, YES C											
1.2 NO*, NO* C											
1.3 NO**, NO** C											
1.4 NO											
1.5 TOTAL											
Section 2 - Political Subdivisions, Governmental Agencies & Authorities (Groups 2, 3 & 4)											
2.1 YES, YES X, YES C											
2.2 NO*, NO* C											
2.3 NO**, NO** C											
2.4 NO											
2.5 TOTAL											
Section 3 - Other (Unaffiliated) (Groups 5, 6 & 7)											
3.1 YES, YES X, YES C											
3.2 NO*, NO* C											
3.3 NO**, NO** C											
3.4 NO											
3.5 TOTAL											
Section 4 - Parent, Subsidiaries & Affiliates (Group 8)											
4.1 YES, YES X, YES C											
4.2 NO*, NO* C											
4.3 NO**, NO** C											
4.4 NO											
4.5 TOTAL											
Section 5 - Total Bonds											
5.1 YES, YES X, YES C											
5.2 NO*, NO* C											
5.3 NO**, NO** C											
5.4 NO											
5.5 TOTAL											
5.6 Line 5.5 as a % of Column 7 of Section 5							XXX	XXX	XXX	XXX	XXX
Section 6 - Total Bonds Prior Year											
6.1 YES, YES X, YES C								XXX	XXX	XXX	XXX
6.2 NO*, NO* C								XXX	XXX	XXX	XXX
6.3 NO**, NO** C								XXX	XXX	XXX	XXX
6.4 NO								XXX	XXX	XXX	XXX
6.5 TOTAL								XXX	XXX	XXX	XXX
Section 7 - Section 5 minus Section 6											
7.1 YES, YES X, YES C								XXX	XXX	XXX	XXX
7.2 NO*, NO* C								XXX	XXX	XXX	XXX
7.3 NO**, NO** C								XXX	XXX	XXX	XXX
7.4 NO								XXX	XXX	XXX	XXX
7.5 TOTAL								XXX	XXX	XXX	XXX
7.6 Line 7.5 as a % of Column 7 of Section 7							XXX	XXX	XXX	XXX	XXX

** Includes aggregate statement value of all bonds shown in Schedules D and DA.

NAIC Designation Definitions:

- YES -- Investment Grade
- NO* -- Non Investment Grade -- Average Quality
- NO** -- Non Investment Grade -- Below Average Quality
- NO -- Bonds in or near default on principal or interest payments

NOTE: The letter "C" following a designation indicates a demand or perpetual obligation valued at original cost.
The letter "X" following a designation indicates the obligation is rated in the top four categories by a recognized rating organization.

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EXHIBIT 2

FINANCIAL REPORTING SECTION -- CURRENT TOPICS IN THE UNITED STATES

Column 11 is (Column 7 - Column 9) Current year totals less prior year totals. Column 12 is Column 11 as a % of line 5.5, the total.

In order to facilitate the review of changes in maturity distribution since the past year, 2 new sections are added -- Section 6 and Section 7.

Section 6 shows Total Bonds Prior Year. Section 7 shows Section 5 less Section 6 -- this year less last year.

GICs -- There has been increasing regulatory concern about the C-1, C-2 and C-3 risks involved with GICs. Additional disclosure is warranted. Interrogatory 32 is added to the general interrogatory Page 17A:

Does the company write any GICs? Yes [] No [] If yes, what amount pertaining to these items is included in the following:

- a. Page 3, line 10.2 -- This is available in Exhibit 10, but is repeated here for convenience.
- b. Page 4, line 1, which is Premium and Annuity Considerations.
- c. Page 4, line 1A, which is Annuity and Other Deposit Funds. This is to show the GIC component of these items.

1990 EXHIBITS OF INSURANCE, ANNUITY AND SUPPLEMENTARY CONTRACTS

1. Pages 15 and 15A, Exhibit of Life Insurance, will remain the same.
2. Page 16 is currently called "Exhibit of Annuities and Supplementary Contracts with Life Contingencies." The new title is "Exhibit of Numbers of Policies, Contracts and Certificates for Supplementary Contracts, Annuities and Accident and Health Insurance." Numbers is the key here (Exhibit 3).

The changes from current practice are as follows:

- a. Annual income for annuities and supplementary contracts will be dropped because it is becoming increasingly meaningless for comparison purposes. There is difficulty in deciding what annual income means.
- b. Supplementary contracts will include not involving as well as involving life contingencies.
- c. Numbers will be required for Accident and Health Insurance and Supplementary Contracts.
- d. Accident and Health includes credit which has one column for both individual policies and group certificates.
- e. Group annuities will require both group contracts, which is new, and number of certificates, which is now required.
- f. Group health will require both policies and certificates, neither of which is currently required.

The addition of controls by number will serve to improve the accuracy of the in force of all lines and hence the reserve determination.

PROPOSALS FOR THE 1991 BLANK

As mentioned, these are in concept form at the moment.

The present organization of the Life and Health Blank is an anachronism not readily adaptable to efficient surveillance of Life and Health Insurers under current market conditions. Major development such as life and annuity products with accumulation accounts (interest sensitive types, if you will), structured settlements and terminal funding annuities are not distinguishable from other more traditional items in the statement.

A basic feature of the proposals is to organize the analysis by lines of business into analysis by the basic nature of the contract with regard to whether they are primarily investment sensitive or claim sensitive. The investment sensitive plans fall into two major categories: those with

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EXHIBIT OF NUMBERS OF POLICIES, CONTRACTS AND CERTIFICATES FOR SUPPLEMENTARY CONTRACTS, ANNUITIES AND ACCIDENT & HEALTH INSURANCE

	SUPPLEMENTARY CONTRACTS	ANNUITIES			ACCIDENT AND HEALTH INSURANCE				
	(Involving and Not Involving Life Contingencies)	INDIVIDUAL CONTRACTS	GROUP		GROUP		CREDIT	OTHER	
			CONTRACTS	CERTIFICATES	POLICIES	CERTIFICATES	INDIVIDUAL POLICIES & GROUP CERTIFICATES	POLICIES	
	1	2	3	4	5	6	7	8	
1. In force end of previous year									
2. Issued during year									
3. Reinsurance assumed									
4. Increased during year (net)									
5. Totals (Lines 1 to 4)									
Deductions during year:									
6. Conversion	XXX	XX	XX	XX	XX		XX	XX	
7. Decreased (net)									
8. Reinsurance									
9. Totals (Lines 6 to 8)									
10. In force end of year, Line 5 minus line 9									
11. Income now payable			XX		XX	XX	XX	XX	
12. Deferred; fully paid			XX		XX	XX	XX	XX	
13. Deferred; not fully paid			XX		XX	XX	XX	XX	

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guaranteed termination values and structures, e.g., traditional life, and those with nonguaranteed values and thereby indefinite structures. Claim sensitive plans fall into two major categories -- term life insurance and accident and health insurance.

These concepts would be reflected in changes to the Analysis of Operations Gain and Loss. A page 5A might be needed to handle the additional columns. These splits would be carried to Page 6, Analysis of Increase in Reserves, Exhibit 10 -- Deposit Funds, and partially into Exhibit 8. Exhibit 1 (Premiums) and 11 (Claims) would remain the same.

The initial proposals were not acceptable when considered in San Francisco earlier this month. Further study is needed. The possibility of an intergraded database is being considered as a means of providing this kind of information.

MR. SMITH: Next, we have Bob Stein who is the National Director of Actuarial Services for Ernst and Young. He is also a member of the Academy Committee on Relations with Accountants and is, in addition, Chairman of the Committee on Valuation and Related Areas (COVARA). Bob is going to summarize the important items concerning FASB, the Emerging Issues Task Force, the AICPA and COVARA, which hopefully will cover the rest of the topics that we haven't yet spoken about on the program.

MR. ROBERT W. STEIN: I would like to make a brief review of the life insurance, health care and, in some cases, pension issues and activities being addressed by the AICPA, FASB, the Emerging Issues Task Force, and the COVARA. Each of these professional bodies is addressing issues that would affect actuaries working in life, health care and pension areas.

AICPA

First, the AICPA insurance companies' committee is working on several projects to help implement previously issued FASB statements. Task forces have been established with respect to FAS 96, on federal income tax accounting, and FAS 97, the universal life and annuity accounting guideline. With respect to FAS 97, a question and answer (Q&A) document has been prepared and approved by the AICPA Accounting Standards Executive Committee. The Q&A is now considered suitable for issuance, although the form and timing of its release are unclear. The Q&A will not be high on the authoritative literature list, but it will be a useful reference to those addressing FAS 97 implementation issues. Similarly, work on a Q&A for FAS 96 has been underway. However, it is currently on hold until FASB resolves the final implementation timing of the basic statement.

The AICPA health care committee also has been active in areas of interest to actuaries. First, a Statement of Position regarding accounting for continuing care retirement communities is being prepared. This document involves many actuarial issues and is presently moving through the AICPA structure. From there it will be transferred to FASB, where its approval will be sought. At present, the document contains guidelines that conflict with the valuation methods and procedures of the actuarial profession. It is hoped that these differences will be reconciled prior to the final adoption and dissemination of the statement.

Similarly, a Statement of Position on accounting for prepaid health care services (HMOs and the like) is now effective. This document contains guidance on establishing reserves for incurred but not reported claims and for recognizing losses on outstanding contracts. Actuaries practicing in this area should become familiar with the statement's guidance.

FASB

FASB has not been active in insurance issues lately. However, it has addressed various pension and benefit issues. The most notorious of these, of course, is the exposure draft on post employment benefits other than pensions. As indicated, an exposure draft on the accounting requirements to recognize such benefits has been released. Hearings on this topic will be held in October and November. We understand that FASB is seeking to better define these requirements during 1990 and would like to implement a statement in 1992 or 1993.

NAIC

The NAIC Emerging Issues Task Force examines many accounting and annual statement oriented issues. Perhaps the most interesting for actuaries is its review of the proper statutory accounting for securitization transactions. There is considerable interest in these transactions and the task

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force is seeking to develop guidelines to assist in determining whether such transactions are sale or financing arrangements. The specific timing of this guidance is not known at this time.

COVARA

Finally, the COVARA of the Society has been active in recent months. First, its Report on the Financial Implications of AIDS has been published and an additional volume addressing individual disability income business will be completed soon.

Recently, COVARA has been given the responsibility for evaluating and managing the valuation actuary handbook. A task force will be examining the role of the handbook and will seek to define the most appropriate form for making valuation information available in the future.

Perhaps most importantly, a task force has been formed to extend the committee's previous analysis of the C-1 risk. Earlier, as included in reports presented at the annual meeting in 1987, the committee has studied default experience and presented methodologies for quantifying the C-1 risk. The objective of the current task force is to develop practical guidance to actuaries involved in the evaluation of the financial impact of the C-1 risk. The task force will focus on the cost of default of various types of financial instruments and will seek to provide more specific information on the impact of C-1 risk on the adequacy of related reserves. It is hoped that this work will be completed during the next year and that the results can be made available at the 1990 annual meeting.

MR. SMITH: Before we get started with the question and answer part of the program, there is one other thing to mention. I picked up a copy of a letter from the New York Insurance Department. I haven't seen it yet myself but thought I might just read a couple of things from the cover sheet regarding the proposed First Amendment to Regulation 126. The First Amendment to Regulation 126 would be effective December 1, 1989.

The first change is that Section 95.9(b)(6) clarifies the use of annual reserve factors for the bond and preferred stock reserve component of the MSVR when taking into account the risk of default, and the revision provides an example for explicitly recognizing the default in cash flow testing.

The second major change is that Section 95.12(h) adopts the NAIC recommendations concerning the use of Standard Annuity Mortality Tables for structured settlements and other similar contracts. What I think this means is that they are adopting, in effect replacing, Section 95.12(h) from last year, which required grading substandard reserves into standard reserves by the end of 20 years from issue, and adopting, in effect, guideline IX-A which was adopted in June of this year by the NAIC.

Finally, Section 95.17 liberalizes the special considerations for small blocks of business. There are different requirements for companies of different size.

Now, I think we will get started with the question and answer portion of the program. To get people started, I have a couple of questions for the panel myself. Don, what is the status of the MSVR and what's likely to be decided by when and by whom?

MR. SONDERGELD: Well, as I mentioned, there really is no MSVR proposal. The Tweedie Committee's Report did discuss the MSVR and did have some material that was contained in an appendix which it was believed would be a good basis for considering changes in the MSVR. To try to move along the concept of the valuation actuary or qualified actuary, we did not want to get into a debate on just how these changes should be structured with the MSVR. I can give you a little more detail on the MSVR.

The report really had recommended, as part of the changes in the valuation law, that relatively minor changes would be considered at this time, but that major changes should be considered later by another group, which is a painfully slow process. If someone had asked me early this year where we were going time-wise, I would have said that I thought there was a real good chance that Tweedie Committee recommendations would be adopted at the December 1989 meeting of the NAIC. We are now looking at perhaps December 1990, or maybe June 1990. Part of the strategy of getting them adopted by that time was to not have the package include the MSVR. The recommendations, if adopted by the NAIC, would produce model regulation and model laws that then must be adopted by each individual state and that takes three, four, or five years, because

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state legislatures don't meet every year and even when they do, that doesn't mean that a particular law is going to be adopted that year. So we are looking at a rather long drawn-out process which I think is an area in which changes should be considered. I personally think that there should be more radical changes in the Valuation Law than what we are talking about to better accommodate these changes and to give more flexibility to the actuary.

I would like to see the profession, the Academy especially, dictate to its members what to do, as opposed to waiting for the states to get tired of waiting for the actuarial profession to decide what to do. Some states, such as New York, come out with very good regulation because there are no other standards that are being given to the actuaries to utilize.

MR. SMITH: I noticed in Harold Ingraham's presentation that under the ASB reinsurance standard, mirror reserving was not going to be required. The reinsurer could put up more or less reserves than the ceding company has taken credit for. Either more or less would be acceptable. Has there been any reaction from the regulators?

MR. PHILLIPS: None.

MR. SMITH: OK. That's short and to the point. Now, a question for Bob or Harold with regard to recognition of losses under FAS 60 or FAS 97. Does the ASB have comments or give guidance, or to what extent does it give guidance, or do you just have any comments in general about when you should go about recognizing losses -- particularly on products like Universal Life, which are adjustable? Should it be done just by year of issue or by line of business or both? Give a little more information on when and what you have to do.

MR. STEIN: I have only seen a preliminary version of the exposure draft and I'm not absolutely sure what it contains in detail. My recollection is that detailed information is not included in the exposure draft. It's a more general application of GAAP principles sort of thing, almost mandating just following FAS 97 and so forth.

The loss recognition situation for any particular product line is only partly impacted by FAS 97. My first response might be the general principles that were there with respect to loss recognition under FAS 60 are only slightly modified by FAS 97. So to that extent, the FAS 60 guidance would still control. Under FAS 60, as you no doubt are aware, there is a large gray area with respect to loss recognition among different products, whether we can encompass more than individual life business and so forth. But the loss recognition and recoverability statements are relatively broad.

I think, in general, what we found is that companies are isolating the Universal Life business. I wouldn't say that I've seen many companies go beyond that in terms of identifying selected segments of the Universal Life business, but rather they embrace the Universal Life business in total and take a look at it. I would be surprised if the actuarial profession came up with any more specific guidance on what categories of business within the company to provide losses on.

MR. INGRAHAM: I would only add or just reinforce what Bob said having to do with the thrust of the standard. It was not intended to provide a detailed blueprint, but rather it was intended to give the actuary general guidelines. I think this is actually the intent of all the standards we are producing. We are not trying to tie the actuary's hands as sometimes I've seen in the Canadian Institute, which says this is the way you must do things and you cannot deviate. I mentioned, when I gave my prepared remarks, that the Academy believes that the ASB's attitude ought to be "disclosed defensible deviation," to give the actuary room for some range of interpretation. So I think that's why the standard was as general as it was. There was a deliberate intent to provide some degree of freedom.

MR. SMITH: A number of companies are involved in structured settlement annuities, which are an example of really a long-term liability. Companies that were in the business back in the early 1980s, when interest rates were high, have had capital gains because of the decline in interest rates.

When a capital gain occurs, particularly on a single premium product, it is tantamount to front-ending some of your earnings. For both GAAP and Statutory, when you get capital gains, you may have to pay taxes and you then have less investment income in the future.

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At my company, which is in settlement annuities, we believed it would be appropriate to put some of those capital gains aside to strengthen the reserves, but we weren't allowed to do that because our auditors indicated that FAS 60 says you can't do that until things get so bad that the present value of future profits is a loss. However, here comes FAS 97 and you are basically required to do just that. Not only are you permitted to amortize capital gains (through greater deferred acquisition cost [DAC] amortization), you are actually required to do so. Why the inconsistency? What do the accountants have to say about that?

MR. STEIN: Well, I don't want to speak for all the accountants, but they might say they've maybe learned something in the last few years and maybe not, depending on what you think of FAS 97. When you get into the investment and contract area there is some grayness and the Q&A that the institute was working on attempted to deal with some of those issues.

With respect to the realized gain or loss situation, my recollection of the present form of the Q&A is that they were fairly strong in suggesting that you need to take into account realized gains and losses in the gross profit margins streams and so on that underlie the FAS 97 calculation, so that if you follow strictly what they advise to be the proper approach, you will at least get some offsetting impact from redoing the reserves and amortization schedules on those investment products when realized gains are taken. So there is some ability there to recognize that situation and provide a middle of the road kind of position.

The other point I might make, which may be a minor one, is that from an accounting standpoint, to the extent there is DAC maintained in support of one of those investment contracts, I don't believe there was ever any debate, from the accounting side, in any event, that you should be able to recognize losses on investment contracts, at least to the extent of the DAC balance. The future value of the DAC should get evaluated at a bare minimum. You could write off that amount, but probably not go so far as to strengthen the underlying reserve. I think there was at least a layer there that generally the accounting profession recognized should get assessed in terms of recoverability on an annual basis.

MR. SMITH: On investment contracts then, you don't really need to get to a loss position. For example, if future spreads are going to be considerably lower, would that in effect cause you to write down some of your DAC?

MR. STEIN: I probably wouldn't have described it that way, but you could view it in terms of different layers of loss. To the extent that you have some loss that would absorb a portion of the DAC balance, I think those generally should be written down. At least you could go that far without having to address the adequacy of the basic reserve side of it.

MR. INGRAHAM: Steve, this discussion of interest sensitive contracts brings up another item that I think is worth exploring. As I mentioned earlier, the standard that's going to be up for exposure very soon on when to do cash flow testing notes that the need for the testing will depend on the nature of the risk. The type and depth of the actuary's cash flow testing analysis should relate to the type and severity of the asset and liability risks.

Among other things, this means that even though a company might be small, if it is involved in, let's say, GIC business or some other business where there is a high degree of risk, there should definitely be a degree of cash flow testing. This collides to some extent politically with some of the statements of the National Association of Life Companies (NALC) and ACLI. I would like to get Hal Phillips' comments, among others, as to how we are going to be able to reconcile some of these differences and conflicts.

MR. PHILLIPS: I wish I could answer that. I guess I don't have any comment on how that is going to be reconciled. It is a political process, and I hope it will work out to the benefit of the small companies.

MR. SMITH: Hal, while we sort of have you on the spot, I have a question for you, too. You talked about the Blanks Task Force and what the various proposals are. Could you make some comments about how any of us might go about suggesting changes to the annual statement and what the procedure is, not only for making proposals, but for offering comments on various proposals that exist, or maybe how can you go about following the progress of the proposals?

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Some of the things you mentioned I had not heard before. How do you go about trying to keep track of them and get on a mailing list or something so that you can offer comments at an appropriate time?

MR. PHILLIPS: That's a very good question. Personally, I'm working on how you might do that too. I am new to the California Department and I'm learning how things proceed through the various committees. My suggestion is to get the minutes and follow them if you are interested. These things tend to take a couple of years. They are exposed, discussed and then they are adopted or rejected or sent back for further study.

MR. WILLIAM D. WARD: There are several ways you can interact and become knowledgeable about blanks procedures.

The NAIC has an addition to the subscription that Harold referred to, i.e., the minutes of the task force. Prior to each year's Blanks Task Force meeting, they put out an agenda. There is a call for agenda items to be sent to the central office of the NAIC in Kansas City and that is as of July 1st. All items have to be in to the NAIC's central office by July 1 for the annual Blanks Task Force meeting the first week in October, which then considers the actions for affecting the following years blanks. If your company is a member of one of the trade associations such as the ACLI or NALC, there are Blanks Task Force industry groups which also go over the Blanks and bring together suggestions from the member companies. So there are various ways one can provide suggestions and follow the Blanks Task Force. Attendance at the meetings is even better. Those of us who are involved in the trade associations do welcome suggestions and we also put out requests from member companies for blanks consideration.

MR. SMITH: Who's in charge of the ACLI committee?

MR. WARD: The staff person is Bill Caroll. He would be the person, perhaps, to write or call. The current chairman of the ACLI Committee on Statutory Financial Reporting Principles is Peter Storms at the Travelers.

MR. SMITH: One of the proposals for 1990, or maybe it was 1991, was to change the lines of business. That could require some fairly significant changes to accounting, and is something that you would want to get a good handle on and try to understand well in advance because changing your books of accounting isn't always easy.

MR. WARD: I wanted to comment briefly on the MSVR topic. The material in the Tweedie Report, that Don referred to earlier, has now been referred to a Valuation of Securities Task Force working group. This was done in September of this year. An advisory group has been formed and I am chairman of the advisory group. We are planning our first session on November 2nd in Washington. I anticipate that the complete study of the MSVR, which we have been charged with doing, will include developing the objectives of and purpose for an MSVR, and deciding to what assets it will apply. As a part of the Tweedie Report, reference was made to extending the concept beyond just simply the securities assets, also perhaps including mortgage loans, schedule BA assets and other forms. This will be undertaken by a group which will consider not only the Tweedie Report but other reports that have recently been rendered to the NAIC, of which there are two.

Perhaps we will also look at the work being done in other countries on the same subject. Canada and the UK are both actively engaged in very similar efforts. There is also a Society research project on Asset Default. I think that this process is probably going to take 2 to 2 1/2 years.

MR. SMITH: If you have comments or suggestions for topics for future sessions, the Financial Reporting Section would certainly like to hear about them.

