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Current Events in Financial Reporting

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Summary: The status of emerging issues in financial reporting will be discussed. These will include the National Association of Insurance Commissioners (NAIC) codification project and other NAIC issues as well as any new developments at the Securities and Exchange Commission (SEC) or Financial Accounting Standard Board (FASB).

Mr. James D. Wallace: I'm the president of National Travelers Life Company, although I'm new in that role. For the past 20 years I was with Ernst and Young, where I was an audit partner and an actuarial consultant. Our other speaker is Donna Claire, who runs Claire Thinking. Donna is easily the most active actuary I've ever met. There may be a more involved actuary than Donna, but I certainly haven't met one. She's on about every actuarial committee there is. I'll just give you some of the highlights. She's on Committee on Life Insurance Financial Reporting (COLIFR) of the Academy, which I'm also on. She's on the Committee on Life Insurance (COLI). She's on the Society Board of Governors.

She's a Society representative to the Life and Health Actuarial Task Force. She's on the State Variations and Valuation Issues Task Force and the Society Illustrations Practice Notes Committee. She's the chairperson of the Academy Life Practice Notes, and it goes on and on.

We're going to cover current topics in accounting that affect actuaries. There's a lot going on in accounting, but obviously we're going to limit it to what we think is germane to the insurance industry and even more specifically to you. I'm going to cover generally accepted accounting principles (GAAP), where not a great deal is happening, and then Donna will cover statutory accounting practice (SAP), where I think considerably more is going on.

Let me first cover some new GAAP rules that apply to actuaries, passed in 1995, and have now become effective. Remember that we're talking about GAAP here. The first one is Financial Accounting Standard *(FAS) 120,* which is titled Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long Duration Participating Contracts. We could spend a day on this topic, but I'm not going to. Briefly, this is the mutual GAAP FAS. It makes mutual and fraternal life insurers subject to *FAS 60, 97*, and *113*. Prior to passing that FAS, mutual life insurers didn't have to follow those FAS standards. As you know, those FAS are the ones that tell you how to calculate reserves and deferred policy acquisition cost (DPAC) and basically how to account for reinsurance on a GAAP basis. So *FAS 120* now requires mutual life companies to follow GAAP rules.

It also allows stock life insurance companies to apply something called Standard of Practice (SOP) 95-1, which tells you how to account for participating contracts on a GAAP basis. Not many stock companies are following that SOP and I don't think many will adopt it, but *FAS 120* permits stock companies to adopt SOP 95-1.

The other important thing about *FAS 120*, which is germane to us, is the reporting requirement. Mutual companies that want to get a GAAP opinion have to follow the new FAS for calendar year 1996.

Another new FAS that passed, which looked like it was going to be far more germane than it turned out, is *FAS 121*, which is "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." What is that all about? Think of a manufacturing company that has a plant and equipment. Sometimes the though certainly some still carry them at amortized cost.

The other important thing the *FAS 115* clarification did was it clearly prohibited providing general allowances for bad bonds. If you have bad bonds you have to write them down under GAAP, and what this *FAS 115* guidance made clear was you couldn't hold a general reserve for bad bonds. That, of course, gives the company much less flexibility in managing that reserve.

Another SOP that passed is *SOP 94-6*, "Disclosure of Certain Risks and Uncertainties." This turned out to be much less than it appeared. It required companies to describe their operations and the risks inherent in their operations in their financial statements. Based on a survey of lots of life insurance company financial statements, basically all that most companies did in response to this SOP was to disclose that financial statements contained some numbers which were based on estimates which, of course, is about everything that actuaries do, i.e., reserves and DPAC. Very innocuous results came out of *SOP 94-6*, and so that may get amended.

Another SOP that passed in 1995 was 95-1. I referred to that one earlier. That's the one that covers accounting for certain insurance activities of mutual life insurance enterprises. That's the one which described to mutuals how to account for participating business. I'm not going to go through that. There are separate sessions on that very topic. We could spend, again, a two-day seminar on that particular SOP, but the short of it is that for qualifying participating life insurance contracts you had to follow a *FAS 97* model, where the reserve, or the account balance, was defined as basically the statutory, net-level premium reserve following cash-value assumptions. This was a profound change for the mutual life companies.

There also was an SOP related to all of this that got issued titled "Auditors' Report on Statutory Financial Statements." Prior to *FAS 120* and *SOP 95-1*, which basically defined mutual GAAP, a mutual company that produced statutory financial statements would get an opinion from an auditor that would say those statutory financial statements were prepared fairly in accordance with both statutory requirements and GAAP. If you were a stock insurance company and produced statutory financial statements, then the opinion would be adverse to GAAP. It would say your financial statements didn't follow GAAP. If you were a mutual company, statutory was defined as GAAP. All these new accounting rules on mutual GAAP have required changes in the auditors' reports, so no longer will a mutual company which produces statutory-based financial statements get a clean opinion on their statutory statements. As you can imagine, it's caused quite a bit of difficulty, especially with the states.

An opinion on statutory financial statements for a mutual or a stock company that is going to be available for general distribution, meaning you could hand it out to policyholders, will have to have a paragraph in it stating the financial statements are not presented in accordance with GAAP. Under this new SOP, companies will still be able to issue statutory financial statements to regulators that are limited to a review by regulators. The financial statement will receive a clean statutory opinion.

One interesting twist this SOP addressed was codification, and Donna will talk a lot more about codification. Once codification is done, any deviation that you take in your statutory financial statements from what's codified will be considered an exception under American Institute of Certified Public Accountants (AICPA) rules. Even if the state of domicile approved it, it doesn't matter. Once we have codification, once there's a body of literature ththough certainly some still carry them at amortized cost.

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Here is another interesting wrinkle on this issue. Many mutual companies sponsor separate accounts. Currently, the SEC permits mutual life insurance companies and stock life insurance companies in certain, very limited circumstances to file statutory-based financial statements in their filings with the SEC as a sponsor of a separate account or other vehicle that requires SEC registration. They haven't said this yet, so this isn't an official statement, but it now appears the SEC may no longer accept, in the very near future, statutory-based financial statements from mutuals. They're going to require GAAP. That's the bad news. The good news is that in rethinking the whole issue the SEC is seriously considering not requiring the statements of the sponsor in the registration of the variable account at all. So, if you register your variable account with the SEC you currently include the financial statements of the mutual life company. In the future those statements may not be required at all. But if they continue to be required and the SEC hasn't decided, they're probably going to have to be GAAP. None of that's currently official yet, but it looks like that's the way the wind is blowing.

Other GAAP proposals that are out there that you should be aware of:

- The "Insurance Agents and Brokers Audit Guide," which will explain income and expense recognition rules is close to being issued. Last time I checked it wasn't yet. This has been in the works for over 15 years. Why it's taken so long to get out no one seems to know, but it may be out soon.

- Another SOP that's been drafted which affects us is "Accounting for Guaranty Fund Assessments." The states are all over the map on how you account for guaranty fund assessments with some prohibiting an accrual for guaranty fund assessments and others requiring it. But for GAAP purposes there is a draft SOP that was produced by the Insurance Companies Committee. It went up to the Accounting Standards Executive

Committee, a very high body in the accounting world, which approved it. The SOP went on to FASB and FASB rejected it, and here's where it currently stands. What the SOP prescribed as the rule for accounting for guaranty fund assessments is this: once the insolvency has occurred for which you're going to be assessed and once you've written the premiums that will be used for the basis for your assessment, you have to accrue a liability. It sounds like it makes sense.

So a life company, Company X, went bankrupt in 1995 and maybe the states are going to use 1995, 1994, and 1993 premiums to figure out what your share of the assessment is. As soon as the company went bankrupt you would have to accrue a liability, because the insolvency occurred and you've already written the premiums. But in other cases in some states, and this is especially true for property and casualty companies, you don't necessarily use historical premiums. You might use 1996, 1997, and 1998 premium. If that's the case, the paper that went to the FASB said you wouldn't accrue a liability until you wrote those premiums, because even though the insolvency happened, you might not write anymore premiums that would cause you to be assessed.

FASB didn't like that. They said once there's an insolvency you should accrue for it. The compromise is that the Insurance Companies Committee position is going to prevail. FASB is probably going to say in the FAS this is the current proposal, that once the insolvency occurs you do have a liability, but the triggering event, that is, what requires you to actually book the liability, doesn't occur until you write the premiums.

Another draft SOP that The Committee on Life Insurance Financial Reporting is watching fairly closely is one on *FAS 113. FAS 113* is the FAS that tells you how to account for reinsurance contracts on a GAAP basis. The problem with *FAS 113* is that many "reinsurance" contracts don't qualify as reinsurance under the definitions set forth in *FAS 113.* This is especially true for property and casualty companies, and if you don't qualify as a reinsurance treaty under *FAS 113,* then the accounting you follow defaults to what's called "deposit accounting." What's that? That's not codified anywhere, so a SOP is in the works to define what deposit accounting is and how property and casualty companies ought to account for contracts that fail *FAS 113.* Why this is germane to us is under GAAP, deferred annuities are not insurance contracts. They don't fall under *FAS 113.* If you don't involve life contingencies, then you don't end up in *FAS 113.* Of course, there are many reinsurance treaties out there involving annuities, so we're going to carefully monitor this SOP to make sure it doesn't change what current practice is on accounting for life contracts that don't qualify under 113, again, deferred annuities being the big one.

There's another draft out there which is the "Audit Guide for Stock Life Insurance Companies." The audit guide, which is a rule book for doing GAAP for life insurance companies, was written back in 1973. Obviously, since then we've passed *FAS 97, FAS 120,* and *FAS 113.* None of that is in the old audit guide, and so a new audit guide is being prepared, and in theory the new audit guide is not supposed to create new accounting. It always does, because of the way things are worded. People will look at the audit guide for support for the way they want to account for things, but in theory the audit guide is not supposed to change current accounting. It will change current audit procedures somewhat.

One interesting problem on the mutual GAAP financial statements is the problem in some states of producing and publishing GAAP financial statements as a mutual. In fact, in some cases it may actually be against the law. The American Council of Life Insurance (ACLI) is currently working on this particular issue. They think the problem is limited to New York, but there is some issue about the ability of insurance companies to actually publish GAAP financial statements.

Fair market value of liabilities has been a big issue for our industry. As you know, the SEC and FASB required the insurance companies, as a practical matter, to mark all the bonds to market. It isn't quite that carte blanche, but close. But we can't mark liabilities to market. FASB basically said, "We know we have to mark them both to market. We know how to mark the assets to market. We don't know how to mark the liabilities to market. Let's at least do what we know how to do." This left us, in my personal opinion, in an unfair situation.

There's a lot of activity going on at the industry level. The Society and the Academy have committees looking at this. The ACLI still does, but as a practical matter this is not very high on FASB's list, and it doesn't look like much is going to happen anytime soon. It would be good if it did, but currently there's really no activity going on there.

The last topic I'll cover is derivatives, and this does have some very germane topics relative to actuaries. It could take a week's seminar to explain derivative accounting. I'm not going to try to do that but, in general, to help you understand what's germane to us, what the old rule said was that if you purchased a derivative and if the derivative was a hedge and qualified for accounting as a hedge of an asset or a liability, you would account for the derivative the same way you account for the hedged item. What does that mean? Well, say you want to hedge a bond. If you carry that bond at amortized cost and if you bought a swap to hedge that bond, then since the bond is carried at amortized cost, you carry the derivative at amortized cost. So even though the value of the swap might go way up or might go way down, you carry it at amortized cost as long as it was hedging an item that was carried at amortized cost.

If you bought a derivative which hedged an item you carried at fair market value, say a bond that's in the available-for-sale category, then you would account for the derivative again the same way you account for the hedged item. If the bond gets marked up to market or gets marked down to market, likewise, you would mark the derivative up or down.

What's happened now, in my personal opinion, is a lot like fair-market-value accounting. That is, the SEC really caused FASB to adopt *FAS 115,* and I think the SEC's driving this, too. They really want all derivatives marked to market. We've had some spectacular losses in derivatives, as you know, and the SEC is nervous, I think, about not having derivatives marked to market. So the current guidance, which is changing literally monthly, currently stands as follows (and this is just a draft and may not pass). The FASB is looking at requiring companies to mark all derivatives to market. It doesn't matter if it's a hedge or if it's not a hedge. In the old rules, if it wasn't a hedge, then you did mark the derivative to market and the unrealized gains and losses go right to income. Well, FASB is probably going to make us mark all derivatives to market.

If you qualify for hedge accounting, and it's a tough standard to pass, then you mark the hedged item to market, even if it's something you don't normally mark to market. Let's say you were hedging universal life contracts. Of course, you don't mark those to market. We hold full account balances. But if the program you put together qualifies for hedge accounting, then you can mark the hedged item (in my example the universal life contracts) to market just as you mark the derivative to market, but only to the extent of changes in the fair market value of the derivative. If the derivative goes down $5, you could only mark your liabilities down $5, even though they may have gone down $10.

Here is an important point to us. Currently, the draft position is not going to allow insurance companies to qualify for hedge accounting with respect to held-to-maturity bonds. You can't hedge those, so there goes a big chunk of the balance sheet. You also can't qualify for hedge accounting for insurance liabilities, and that knocks out a big chunk of the balance sheet as well.

It appears as though insurance liabilities means very technically what it says. It means those contracts that qualify as insurance, which would exclude deferred annuities and, frankly, that's where you find most hedges anyway. You find them on pension contracts and deferred annuities. Those are not insurance contracts because they don't involve life contingencies, but this is an evolving area, one you want to watch, especially if your company is heavily into derivatives and if the accounting for them is important to your program.

Ms. Donna R. Claire: There are a number of different projects going on which may affect financial development in the next few years. I will highlight some of them.

STATUTORY CODIFICATION

The statutory codification project of the NAIC has taken on a life of its own. It's original purpose was quite good: the accountants were stating that they would not sign off on statutory annual statements or reports because they were not in compliance with GAAP, so the NAIC is attempting to codify the current statutory principles so that they can be considered another comprehensive basis of accounting (OCBA), and accountants would therefore be able to sign off on their accuracy. This job is proving to be bigger than most people imagined.

The NAIC is having a big-six accounting firm work on these position papers for them. The current firm is Deloitte; Peat Marwick was the original firm. Effectively, it would develop a uniform standard of statutory accounting to be used for all states. This uniform standard, which at one point was advertised as "surplus-neutral," appears to have the effect of increasing reserves for a number of companies. Whenever there was more than one accounting method currently being used, they appear to generally have taken the more conservative interpretation as being the right answer.

Their goal is to have drafts of all the accounting papers, of which there are almost 100, all released in 1996; with the entire set codified in 1997 for possible adoption. The papers are on all aspects of statutory accounting. The papers that have caused the most comments to this point are the ones concerning treatment of some asset types, such as mortgages. (Write-downs are required quicker than they are done by some companies.) Recently, the drafts of papers on reserving and other topics of interest for actuaries have been released. Some of these are the following:

Paper 50: Classifications and Definitions of Insurance Contracts In-Force
Paper 51: Life Contracts
Paper 52: Deposit-Type Contracts
Paper 54: Accident and Health (A&H) Valuation
Paper 56: Universal Life-Type Contracts, Policyholder Dividends, and Coupons
These five papers are being studied by an American Academy of Actuaries' (AAA) Committee on Life Insurance Financial Reporting, under Henry Siegel of New York

Life, who is trying to coordinate the responses from the professional actuaries' point of view.

Some of the highlights from this:

1. The papers attempt to define Commissioner's Annuity Reserve Valuation Method (CARVM). It may just be bad wording, but the way I read it, the greatest present value of all benefits may have to be tested for life insurance. Others have read this section differently.

2. For universal life insurance, they appeared to have given up trying to understand exactly what it says, and state that reserving should be consistent with the model regulation, which I think only about ten states have officially adopted.

3. The papers would cause any model law, regulation, or actuarial guideline to be the basis for statutory accounting—even if the state did not adopt the regulation or law. This would mean, for example "XXX" would be the standard as soon as the NAIC adopts it. There are advantages to this, in that the standard would be uniform between states, but it does appear to trample on state's rights.

4. Certain current statutory rules that are a bit strange may be changed by the adoption of this standard. For example, the current requirement to set up a liability for the "cost of insurance in excess of loading" would be eliminated. There would be other changes in due and deferred premiums and deficiency reserves that would make the accounting basis more consistent.

The original estimate was that this project would go through relatively smoothly. Recently, I have heard a number of concerns expressed. Some of the states do not like the fact that these requirements may effectively supersede the duly passed legislation in their state. Some companies are protesting the additional surplus hit some of the requirements may have. At this time, it is anybody's guess as to what the final outcome will be.

LIFE NONFORFEITURE

You may wonder what a topic like life nonforfeiture is doing in a panel on financial reporting. There are three reasons for this: 1) because I like the topic. I generally try to work it in anywhere it may possibly fit. 2) because it is the subject taking up the most time of the Life and Health Actuarial Task Force of the NAIC. Finally 3) because if it does get adopted, it will have a major impact on insurance companies and financial reporting.

Here's a brief update of this project. The Life and Health Actuarial Task Force has been attempting to rewrite the life nonforfeiture law for about 15 years. One of the reasons is that universal life does not fit into the law. In December 1994, they finally said that the direction that they were working in did not work, and there was a need to go back to basic principles. They developed some basic premises and principles, such as one should not overregulate, and that there should be a reasonable relationship in the values given to terminators versus persisters. A Society of Actuaries (SOA) task force expanded on this work, and developed a framework of precepts that could be used to implement this new direction. An Academy of Actuaries group, which had been led by Randy Mire, but is now under the leadership of Walt Rugland, is in charge of developing a white paper on the subject, which will include possible changes to laws and regulations needed to implement this. A draft of this white paper is due to the Life and Health Actuarial Task Force by August 15, 1996.

Some of the highlights of this include:

1. Cash values would be optional.
2. Nonforfeiture (e.g., reduced paid-up and extended term) would be required.
3. No specified formula minimum nonforfeiture values would be required.
4. A plan on how nonforfeiture is determined for each policy form would need to be filed with the states, but not approved before use.
5. An actuary would need to certify that the values illustrated and paid to policyholders follow the plan.

These changes would mean a major shift in the life insurance industry. It would also require that the valuation of such plans take into account these new features. If this new direction in nonforfeiture continues, I expect much work in 1997 on the valuation and financial reporting of the products.

The Life and Health Actuarial Task Force of the NAIC had originally exposed for adoption both the update of the Group Annuity Mortality Tables to the 1994 Group Annuity Mortality table (GAM) and a temporary update of the individual tables using the 1983a Table, with Projection Scale G used to update the mortality to 1996. At the June NAIC meeting, it was suggested that the individual annuity mortality table should be projected to the year 2000 for deferred annuities, and a generational table be used for immediate annuities. Because of this suggestion, the current exposure is just for the adoption of the group tables. The Life and Health Actuarial Task Force is having a conference call to determine what should be done on the individual annuity side. It is probably important for valuation actuaries to consider updating the mortality used in asset-adequacy testing to reflect that people are living longer.

GGG

There has been some confusion regarding the implementation of Actuarial Guideline 33, commonly known as "GGG," on annuity reserving, which went into effect last year. CARVM does state that the reserve should be the greatest present value of all possible benefits. The concern has been raised as to the treatment of multiple benefit streams, such as partial withdrawals followed by annuitization. The Life and Health Actuarial Task Force thought it was clear that these needed to be valued. It was not that clear to some companies; the most public being an article in the *Financial Reporter* by Bob LoLande. Therefore, an Academy task force headed by Steve Preston has been asked to develop any possible needed changes to Actuarial Guideline 33 to clarify this matter.

XXX

The NAIC regulation on reserving for policies with nonlevel premiums or benefits, commonly known as "XXX," has had a tough road to adoption in many states, due to a one-man campaign against it. However, it does look like it is closer to adoption. New York, of course, already has adopted close to it in their Regulation 147. North Carolina has adopted it, effective January 1, 1997, with the caveat that the effective date can be pulled back to January 1, 1998 if other states do not adopt it. Other states that expect to adopt it shortly include Colorado, Illinois, Kansas, Maine, Maryland, West Virginia, and Wisconsin.

TO WATCH FOR IN 1996

There are certain states which do not expect to adopt the regulation on nonlevel premiums or benefits (XXX) that valuation actuaries need to watch out for in 1996. For example, Texas appears to be enforcing their Rule 3.301 on term reserving, which requires reserves to be set up on a segmented basis, similar to XXX, but without the relief of the new mortality tables. By law, in Florida one must set up reserves for the current segment. This requirement will also require reserves that may exceed those under XXX. California has Bulletin 74-11; for 1996, actuaries that do not comply with this bulletin (which has similar requirements to XXX except that it does not allow the updated mortality tables) must provide an actuarial certification based on a gross premium valuation that the reserves for these products are adequate.

MINIMUM DEATH BENEFIT GUARANTEES FOR VARIABLE ANNUITIES

An Academy task force headed by Steve Preston has done a great deal of work on the subject of how to reserve for variable products that have some sort of minimum death benefit guarantees. They are looking at the reserve required to fund both short-term (e.g., an immediate drop in values) and long-term (possible future loss) needs. They expect to propose an actuarial guideline on this at the September 1996

NAIC meeting. Several states, such as Connecticut, are looking to act on this quickly.

ILLUSTRATIONS

This is another of those subjects that one may wonder what it is doing in a report on financial reporting. However, in a number of companies, the illustration actuary and the valuation actuary are one in the same. The work of the two may be linked. To update, the NAIC model regulation on illustrations requires that an actuary certify that the nonguaranteed values shown in illustrations do not exceed those in a disciplined current scale. It requires that this disciplined current scale be based on specified self-support and nonlapse support tests. This is a major project of many companies in 1996. North Carolina has already adopted the regulation, and Utah and North Dakota expect to also adopt for 1997. In California, it is being proposed by regulation, which can go into effect on January 1, 1998. There are many questions on this regulation and the accompanying Actuarial Standard of Practice (ASP). There is an Academy/SOA task force developing practice notes on this issue. A draft of the first round of questions has been released on Actuaries Online . The regulators are also developing questions and answers. A draft of their questions and answers can also be found on Actuaries Online.

THIS STATE

One of the problems valuation actuaries have discovered is the requirement that the reserves comply with the minimum aggregate standard of each state the company operates in. The Life and Health Actuarial Task Force of the NAIC has shown sympathy with the enormity of this task. An Academy task force headed by Shirley Shao has issued their final report on this subject. It is available on Actuaries Online in the Life and Annuities section. The Life and Health Actuarial Task Force has exposed the recommendations for comment. These recommendations are as follows:

1. The actuary's opinion would only be based on requirements of the state of domicile.
2. The actuary may have to notify the states when the company's reserve requirements were different than the standard. This is actually now required by the certified public accountant (CPA) audit report for the list of accountants to list exceptions in the statutory blank.
3. The Section 7 opinions, where small companies did not have to certify as to the asset adequacy of reserves, would be eliminated.

Further work is being done on a central repository, where the states would be required to list any exceptions to the model laws or regulations, which they would require companies to follow.

The regulators look at this as a package deal—the “this state” requirement would only be eliminated if the Section 7 opinions were eliminated. This is only now being exposed for comment; it is expected that some companies may protest. However, from a professional actuary point of view, one cannot justify the small company exception. On the other hand, there is a materiality question; it does appear that the regulators are willing to have small companies not do extensive testing; e.g., gross premium valuation may be adequate for many plans.

Since these changes would require changes to a regulation that was adopted by most states already, the adoption process, even if approved, would not be quick. Roughly translated, at least for 1996, probably for 1997 and possibly beyond, the actuary still must certify the adequacy of the aggregate reserves in each state in which that the opinion is filed.

OTHER TOPICS

There are a few more financial reporting issues which are getting some attention at the NAIC. One is a possible reserving standard for synthetic guaranteed investment contracts (GICs). These products have a number of different features, so setting a single reserving standard is not easy. I expect that the regulatory group looking at this will have a paper out in a few months.

Another hot issue will be the reserving standard for equity-indexed annuities, where principal plus a minimum interest rate is guaranteed and, in addition, there is a guarantee that the annuity will pay as much as, for example, 80% of the increase in the Standard and Poor’s (S&P) 500 index over one, three, or five years. It is currently one of the “new” products being issued, so there is a lot of attention being paid to it. So far, four states have not approved their issue—New York, New Jersey, Vermont, and the latest to recommend not approving is North Dakota. Other states are wondering what reserving standard applies. One regulator has suggested that a Black-Scholes model to value the reserve requirements would be nice. So far, the official standard is CARVM. For this product, this typically translates into a minimum reserve of the cash value. It is very important for the valuation actuary to test the adequacy of the assets backing this product; there is typically options bought that would mimic the underlying guarantee with respect to the index. The valuation actuary should feel relatively comfortable that the options and other assets make reasonable provisions for the guarantees in the contract.

Another topic is risk-based capital. Nothing exciting is happening with this topic. I think the major change I’ve seen is that the mortgage factors for good mortgages went down a little bit, but that’s about it. Risk-based capital is supposed to cover all the risks of a company; not only default, but mispricing and asset/liability mismatch risk. But the question is, is that really the only way to go? There was talk that the seven scenarios of the typical valuation actuary test isn't enough for this. Should we test more? What should we do? It is an open issue and it is sure to generate a lot of controversy, depending on how many scenarios may be required.

As you can tell, a lot is happening on the statutory financial reporting side, but it is not happening all that quickly. The new requirements that will probably effect actuaries for 1996 are the illustration requirements, and possibly XXX. I also strongly recommend looking at what certain states may require for term reserving in 1996.

Mr. Larry M. Gorski: How do the term insurance reserving requirements in Texas and Florida compare with XXX?

Ms. Claire: Really the one in Texas is a segmented approach, so for anything relatively straightforward it's the same as XXX except for the new mortality tables, so they would be more conservative. However, Florida only considers the current segment. It doesn't consider anything further, which sounds like it's actually more liberal, but it isn't necessarily. This is one of the legal issues Florida is getting into. It just says segment, but never really defines what is meant by a segment. So some companies are saying, well, my segment, if I have a life to 95 or a term to 95, is 95 and I'm fine. Frank Dino does take exception to that, so right now it is an open issue. He has a letter in with his legal department to try to clarify it for valuation actuaries this year. But, in general, I would say it's probably at least as conservative as XXX, but it's different. So even if you comply with XXX, you'd have to do a different test for Florida.

Mr. Charles D. Friedstat: I must admit that I have the codification of those papers in my briefcase and haven't had a chance to look at them, but could you give some specific examples in terms of what might result in reserves that are stronger than current procedures? Also, everything I've heard about the nonforfeiture actuary paper, and generally the perception I have, is that some states have reacted very negatively to it and that the likelihood of it getting through anytime soon may not be as optimistic as you indicated. Could you comment on both of those questions?

Ms. Claire: The codification one, again, really depends on what side of the balance sheet you're working on, but the mortgage one is probably one of the more interesting ones. The other one that will be of interest is how reinsurance is going to be handled, and I don't think all the papers are out on that one. But, papers 51, 52, and 56 are the ones I would recommend reading from an actuarial point of view. The deposit-type contracts didn't look that much different, but again they affect all pension-type business, so that's one I would really study. Also the concept that if certain companies are just regional companies, they should consider what would happen if all the model NAIC regulations are going to have to be followed. Again, I'm not saying it's a bad idea, but for some companies that really want us working in only a couple of states, it can make a dramatic difference in the reserves that you're going to have to hold.

In terms of life nonforfeiture, I won't say it's going to be on a real fast track in terms of getting passed by the states, but it's on a real fast track of becoming a document. The states have concerns, and I think the regulators have actually been one of the best groups in expressing their concerns and working with the people who are writing these documents, trying to get something that everybody can live with. I will put in a plug and I hope the ACLI will do the same. They have not actually told us directly what their problems are, so I think there may be more industry concerns that we're not aware of. And I think that's where the general public should let us know what we're missing. They expect this white paper to be adopted in December 1996, or at least it will go up to the parent committee in December 1996. The parent committee can do whatever they want with it.

Ms. Regina V. Rohner: I'd also like to recommend number 54, which is the Individual and Group Accident and Health Contracts valuation. That seems to have a lot of rough spots in it and also requires some increase in reserve, because they don't allow the same leeway as the current model does in Accident and Health reserving.

Ms. Claire: Yes, that's a good point on the Accident and Health one. If you're not a national company, note that different states have different versions of the model Accident and Health regulations. In fact, they may not have any, so what is listed in paper 54 can have a major impact on a lot of companies. As she pointed out, it may not be exactly what you would have expected.