



SOCIETY OF ACTUARIES

Article from:

The Financial Reporter

February 2000 – Issue 41

Section Council Commits to Producing GAAP Textbook

by Tom Herget

Under the leadership of recent and current Section chairs, your Council has committed to creating a new textbook on U.S. GAAP for life insurance company actuaries.

This idea has been percolating for several years. Then-rookie Council member Shirley Shao suggested to then-chair Craig Raymond a dire need for a GAAP reference that consolidated the many sources of authoritative literature. It was evident to those experiencing GAAP for the first time that there is no single, comprehensive source to go to for reference and for education.

The need for GAAP education will accelerate for two other reasons. One is that many companies around the globe are starting to prepare financial statements according to U.S. GAAP. Another reason is that the SOA examination syllabus will be dropping references to country-specific laws and practices. This escalates the mandate for professional development support.

So, it was decided that it would be a very worthy cause to use Section resources to create a GAAP textbook.

The project was initialized last spring with a Project Oversight Group. The POG comprises Tom Herget, Mike McLaughlin and Shirley Shao. The POG, with Section Council approval, appointed Herget as the chief editor and project manager.

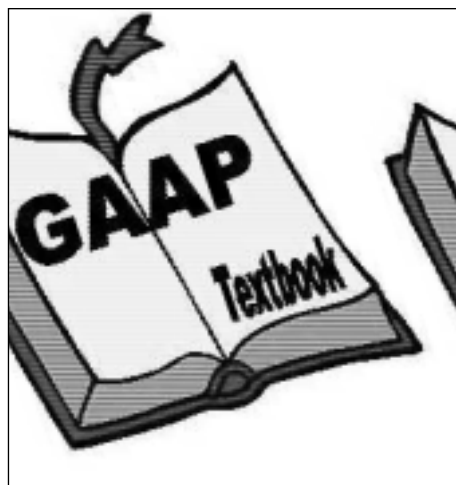
The editor identified, contacted and persuaded nine authors to participate in this project. These nine volunteers are enthusiastically involved in researching and writing at this very moment.

The authors are Frank Buck, Dan Kunesh, Tom Kochis, Mike McLaughlin, Ed Robbins, Dave Rogers, Eric Schuering, Brad Smith and Jay Zellner. All but Tom Kochis are members of the Society of Actuaries. Mr. Kochis is a CPA and partner with an accounting firm. His insights on objectives of GAAP and investment accounting will be very valuable.

The authors were selected based on several criteria. One was that each had 20

years of experience with GAAP. A second was exposure to many companies in the industry. The third was a proven ability to be a good communicator.

An initial planning meeting was held in June of 1999. The authors and editor met for nearly a full day to discuss the scope of the book. Much debate focused on distinguishing principles from practices. The text will focus on principles based on existing accounting literature rather than enumerating common practices in the industry. The authors will strive to elaborate on what should be done rather than inventory the many practices that do



exist. However, several chapters will be devoted to practices where the principles are not defined.

This book will be a good source to learn, in a comprehensive way, how to apply U.S. GAAP.

The text will address these topics:

- Objectives of GAAP
- Background of GAAP
- Expenses (categorization, capitalization and definition of maintenance)
- Traditional Life under FAS60
- Traditional Life under FAS120
- Universal Life (fixed products)
- Deferred Annuity (fixed products) under FAS91 and FAS97
- Variable and other non-fixed products

- Income paying annuities
- Individual health
- Credit insurance
- Group contracts
- Investments
- FAS115 Shadow DAC
- Purchase Accounting
- Product classifications and GAAP for non-USA products
- Reinsurance
- All Other (deferred taxes, riders, fair value, and closed block)

The expected length is between 300 and 400 pages. It will include full narrative discussion of all topics plus formulas, reserve calculation examples and financial statement displays.

The process of writing this book is a little different from other collaborative efforts. There have been three writing meetings. The authors convened for four-day periods in a somewhat isolated location. All the authors brought their PCs and met in a conference room; cell phones were checked at the door. The authors wrote individually but frequently discussed and debated issues with the entire group. For example, the authors had a lively debate as to exactly which purchase accounting practices are addressed in authoritative literature.

Each author was assigned two chapters to write and two chapters to review. Each author selected areas where he could offer significant experience and expertise. By working together as a group, there were several benefits. One, the style of writing became more uniform. Two, the depth of coverage converged. Three, the authors worked together to distinguish principles from practices. The reader will be able to know what should be done, rather than reading about what has been done.

The writers have kept in mind the three target audiences. One is the near or recent Fellow who needs education on GAAP. A second target is the seasoned accountant who wants to know what the actuaries are doing. A third is a non-U.S. actuary who needs education in order to establish

Highlights of the December 1999 NAIC Life and Health Actuarial Task Force Meeting

by Raymond T. (Ted) Schlude

Editor's Note: The NAIC Life and Health Actuarial Task Force met on December 3-4, 1999, and discussed the following projects related to life insurance and annuities.

Innovative Products Working Group

The Innovative Products Working Group discussed the following projects:

Variable Annuities with Guaranteed Living Benefits (VAGLB)

The American Academy of Actuaries representatives presented an interim report of the VAGLB Working Group.

Discussion focused on reserve methods being used by companies in

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GAAP accounting for his or her company.

The authors have set a goal for completing all writing and reviewing by June. This will permit the first set of published books to arrive in time for distribution at the SOA's annual meeting in Chicago. There will be a special session where the authors present the text and discuss its content. Those who attend will have the opportunity to receive a copy of the book autographed by all those authors in attendance.

Order forms will be available soon. You should start thinking about how many you want to order. In addition to gracing your own book shelf, don't overlook these as possible birthday or holiday gifts to friends.

The Section wishes to thank its members who are supporting this project.

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practice, risk management strategies in use, a review of the effectiveness of the Keel Methodology applied to GMIB designs and use of a limited flexibility approach to reserving which could be a substitute or replacement of the Keel method and one that would be considered a CARVM compliant approach.

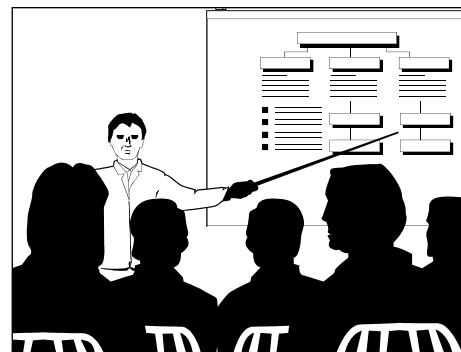
Reserve methodologies currently being used in practice fall into three main categories:

- (i) **Modified Actuarial Guideline 34 Methodology:** This approach includes AG 34 drops with significantly lower assumed returns than those contained in AG 34 itself which follows some of the initial conclusions of the VAGLB Working Group.
- (ii) **Retrospective Net Premium Method:** The expected cost at issue is used to determine a net premium for the VAGLB, which is reflected in a traditional reserve accumulation formula.
- (iii) **Market Value Approach:** The reserve is determined as the then market value of the embedded optionless the present value of future net premiums.

Reinsurance has played a significant role in some valuation methods, particularly those that cede off most or all of the VAGLB risk.

With respect to the Keel method, additional testing and analysis indicates that a single scenario Keel methodology works well for roll-up GMIB and roll-up GMAB designs currently in the market, but it is not an appropriate methodology for ratchet GMIB or ratchet GMAB designs.

The VAGLB work group reviewed whether AG 35 "Option Cost" methods should be pursued for VAGLBs and concluded that neither book value nor



market value methods described in AG 35 appear to work very well for VAGLBs.

Finally, the VAGLB working group recommended that a "Limited Flexibility" approach be pursued as one approach to developing CARVM compliant reserves for VAGLBs. This approach would provide the valuation actuary some limited flexibility in the determination of representative scenarios developed by the valuation actuary for VAGLB reserves. Return scenario assumptions would be standardized. The actuary would provide a certification that the representative scenarios meet the standardized benchmarking requirements.

The work group has a small number of remaining issues including looking at GLBs and MGDBs in combination, continuing to review other reserve methods for VAGLBs and to bring reinsurance into the analysis.

Because very little reserve accumulates in early years under the VAGLB reserve methodologies, provision for Risk Based Capital has been the most critical current issue. As a stopgap measure, the 1999 LRBC instructions were modified per an AAA recommendation to include provision for VAGLBs. A 1% C-3 factor will apply to the entire reserve (variable account value related reserve plus VAGLB reserve) provided an unqualified reserve adequacy opinion is submitted and the fund balance is not less than the effective floor. Otherwise, a 2% factor would apply.

Reserving for Equity Indexed Life Insurance (AG ZZZZ)

AG ZZZZ had been referred back to LHATF by the Life (A) Committee because a new method that stabilized reserves had been added to AG ZZZZ

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