THE FINANCIAL REPORTER

NEWSLETTER OF THE LIFE INSURANCE COMPANY FINANCIAL REPORTING SECTION

NUMBER 46 JUNE 2001

Letter from the Editor

by Thomas Nace

In this newsletter, you will be provided a lot of information addressing what's going on in our Section. In addition, our usual attempts at providing technical articles that help stimulate one's mental appetite have not failed. Hopefully, no one out there is on a mental diet.

In terms of "Wasss Uuuuupp," we are providing in this issue an overview of the major projects which the Financial Reporting Section is undertaking this year. You might be surprised at all that the Section does on your behalf.

I am also including a listing of the seminars that the Section will be offering this year. The dates and sites for most of these have been set. We are offering some of the seminars that have been so well received in the past, as well as a couple of new ones. The topics for the newly offered seminars were generated by survey responses from our members at last year's Annual Meeting.

Mike Eckman, our Section Chair, complements the effort to keep everyone informed with his views on Section activities, as expressed in the Chair's Corner. Mike incorporates the latest developments from his

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Fair Value — A Practical Challenge

by Roger W. Smith

Fair value of liabilities is an issue that has consumed significant actuarial resources in the last couple of years, and the forecast is for more months of discussions and deliberations before the issue settles down. We are truly fortunate that so many talented members of the profession are able to keep an active dialogue moving. The energy level is impressive.

Many topics are being discussed. The direction is to form a solid theoretical foundation that will equip us all as we calculate the fair value of liabilities. The theoretical work covers a range of topics. The actuarial appraisal method is equivalent to the option pricing approach.

We study the many issues involved in setting discount rates. The market value of margins occupies considerable discussion. We examine the techniques used in pricing assets.

It seems that we might have enough tools to finish this fair value job.

I continue to wonder, though, if the theory will carry us to a satisfactory conclusion. Clearly, assumptions will be

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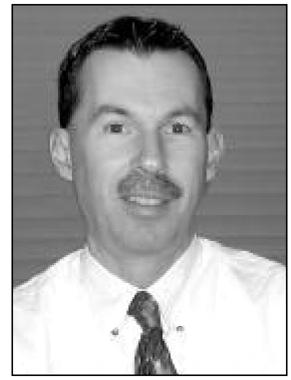
meeting of all SOA Section Chairpersons on May 1.

Deb Poorman, the Section's new Web site liaison, authors an article describing her new position and what we might expect in terms of electronic communications.

Finally, the communication barrage ends with an announcement of an upcoming Academy seminar. If you are an actuary who is responsible for life or health actuarial certifications, this seminar may be for you.

Our technical articles in this issue all share a common thread — they deal with works in progress.

Fair value is a topic that has been given much attention in seminars and SOA meetings over the past couple of years. Much discussion continues in this area as the search for acceptable answers rages on. Our lead story by Roger Smith delves into some of the practical issues that must be confronted if fair value is ever to become a reality.



Tom Nace

The Academy's Life Liquidity Work Group, chaired by Donna Claire, issued a report back in December. The Work Group has written an article describing the nature of liquidity risk, the possible tools to manage it, and the issues that the Work Group members have dealt with in their report.

The third technical article has been authored by Bill Schreiner. Bill brings us up to date on the latest developments surrounding a possible new standard nonforfeiture law.

As with the earlier topics, nonforfeiture standards have been the source of much discussion and often a lack of consensus among the key parties involved. Thanks to Bill's overview, we will all have a better idea of where the nonforfeiture talks stand and what the prognosis might be for a satisfactory resolution.

There's a lot to catch up on, so I'll let you get started.

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part of fair value calculations, but will we also need a fundamental rule or principle in order to determine which values are fair and which are clearly not fair. In all of the activity leading to the development of the theoretical infrastructure, are we ignoring a major obstacle that cannot be solved by theory?

The issue I cannot get around, over, or through is the lack of a market for insurance liabilities that will allow us to calibrate any of the models or methods involved. Asset models anchor to observed market prices. It is an essential step.

Some suggest reinsurance or acquisition markets as possible sources of market prices, but at the end of the day, I believe that these sources do not have enough activity to deliver clear information that will allow us to calibrate our liability models.

The work to date has been to determine the fair value of liabilities as of a single point in time. This allows us to form balance sheets, but what about income statements? Once the dust settles on the balance sheet issues, I predict that questions about earnings patterns will be raised almost immediately. Can we look beyond the current discussions and take a preliminary look at this issue? Can we make any definitive statements about earnings under fair value of liability methods?

Let me construct a simple example. Consider a 20-year level premium term policy at issue. We set assumptions and project premium payments, benefit payments, and expenses. Let's assume there are no taxes or any other charges. I develop present values for this policy an instant before we issue it. Here are the values.

Present Value of Premium	1331
Present Value of Benefits	552
Present Value of Expenses	456
Present Value of Margins	323

I can almost hear the questions. What are the discount rates? What are the assumptions? What about reinsurance? Assume for the moment that these values are unquestionably accurate. All of the assumptions are set with 20/20 foresight, and what we project will emerge.

Currently, fair value is defined as an amount that another company would pay or demand to assume the liability, under normal business conditions. What statements can we make about what the fair value at issue should be?

If I put myself in the position of a buyer, I would be willing to pay some amount in order to receive the present value of the margins. The upper bound would be 323. Obviously, I would not pay more than what I would hope to get back.

If I put myself in the position of the seller, I would certainly not pay another company to assume the liability. My minimum selling price would be 0.

In an active market, I would expect the actual transfer price to be between the two amounts. The result would be that the seller and the buyer share the margins in some fashion. If this were a bond, we could gather actual market prices for identical or similar bonds, calibrate our model, and calculate a single unambiguous answer. We don't have a market, and I believe we will eventually need a rule to tell us how the margins would be shared if a market did exist.

We can illustrate the impact that alternative rules for sharing profits would have on the earnings patterns. I present four different earnings patterns. Two of the patterns represent the upper and lower bounds. Two others were chosen to illustrate the effects of possible fair value where the margins are shared by the seller and buyer.

The four earnings patterns that are illustrated in the graphs to follow are described below:

FAS60 This is the lower bound. It assumes the fair value just prior to issue is 0. I release the earnings as a percentage of premium. The seller gets none of the margins, and the buyer gets all of the margins.

Base FV This is the upper bound. It assumes the fair value just prior to issue is the full margin amount of 323. The seller would receive all of the margins, and the buyer would receive 0.

FV #2 This is one possible set of fair values where the value just prior to issue is between 323 and 0. The split in the margins is based on a percentage of premiums. The seller would receive 190, and the buyer would receive 133 of the margins.

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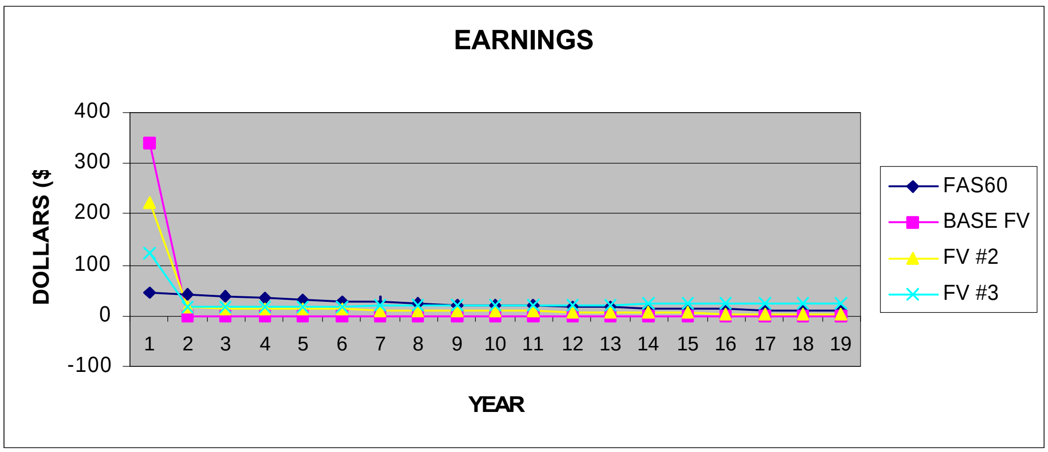
FV #3 This is another possible set of fair values. In this example, the buyer is assumed to charge a larger mortality margin. The net result is that the seller receives 110 and the buyer receives 223.

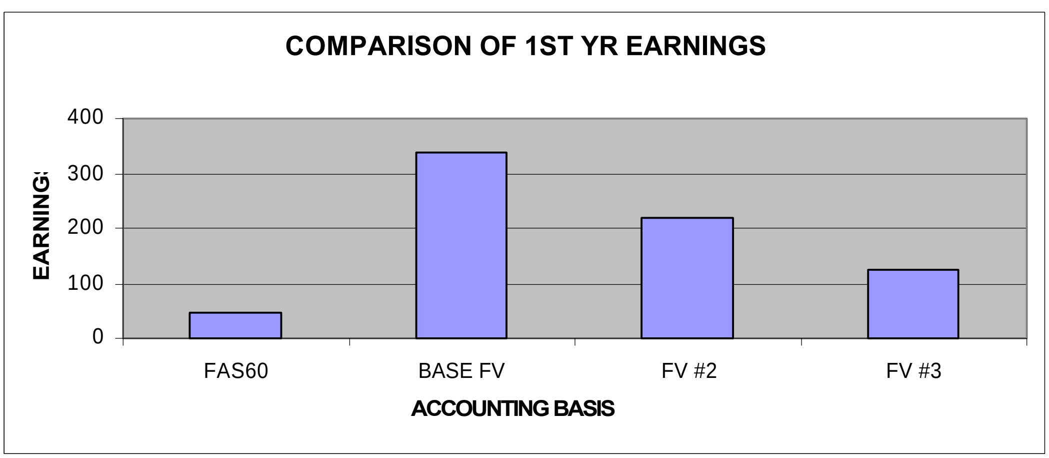
What do the results show?

Chart 1



While it is difficult to differentiate between the graphs in Chart One after year two, it is clear that, except for the FAS60 line, most of the earnings are recorded in the first year. Let's look at the range of the first year earnings.

Chart 2



This is revealing. The difference in Chart Two between the first two bars is quite large. The second two, FV #2 and FV #3, both develop considerably more earnings than the current FAS60 model.

What can we say for the earnings in subsequent years? Reporting more earnings in year one means that less earnings will be reported in later years. (see Chart Three)

The FAS60 earnings show the familiar pattern. The Base FV pattern reported all profits in the first year, and there are no renewal year profits. The FV #2 series falls between the FAS60 series and zero. Remember that the FV #2 split of margins was based on premiums and consequently shares a similar pattern as the FAS60 scenario.

The pattern of the FV #3 series is increasing (see page 5). It is less than FAS60 in the early years, and is greater than FAS60 in the later years. In FV #3, the split of margins was not premium-based, but rather was based on mortality margins. This explains the different pattern than either FAS60 or FV #2.

What can we conclude by this short display? Absent any authoritative pronouncement about where fair values should be set and assuming that we cannot develop the theory to conclusively determine a correct set, what can we expect? I see these logical consequences:

1. A much larger portion of total earnings will be reported in the first year of a policy's life than we are accustomed to today.
2. There will be a greater ability to influence the pattern of earnings than exists today. Compare FV #2 to FV #3. FV #2 generates twice as much first-year earnings as FV #3. In renewal years, the earnings generated by FV #2 decrease year to year, while the earnings of FV #3 increase year to year. This is entirely the result of the assumption I made relative to how fair values are calculated. Is either assumption unreasonable?

If You Haven't Purchased Your GAAP

Sales of the new GAAP text book have surpassed the 1400 m
ing! If you haven't purchased your copy yet, what are you w
will surely become a must in terms of desktop references fo
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Liquidity Risk Management

by The Life Liquidity Work Group

Risk management has become more important to many companies, as some of the products being sold and some of the assets being bought require more careful monitoring than in the past. Liquidity risk is one of the types of risk that needs monitoring.

Background

In 1999, two events occurred that raised the visibility of liquidity risk in the eyes of the insurance industry, regulators, and public. Early in the year, a question was raised regarding the acceptability and reserving standards for "downgrade put" provisions in GICs sold to municipalities (muni-GICs). The question was referred to the NAIC's Life & Health Actuarial Task Force who, after extensive discussions with the life insurance industry, sent state insurance departments a letter outlining the unique risks inherent in the provision.

In August of 1999, General American Life Insurance Company voluntarily sought state insurance department supervision when the demand for cash under funding agreements with "7-day put" provisions exceeded the amount that could be raised quickly. As a result, the NAIC recognized the need to have a better understanding of potential liquidity risks and appointed a Life Liquidity Risk Working Group to examine the issue.

The NAIC's Life Liquidity Risk Working Group meets at the quarterly NAIC meetings and also has interim conference calls. Its goal is to make recommendations to its parent committee by the winter of 2001. Certain states are taking a closer look at liquidity risk. For example, New York issued Circular Letter 33 in 2000 asking a series of questions regarding liquidity risk and whether the company has a liquidity plan.

At this time, it appears that the New York approach is gaining popularity, i.e., not to develop a proscriptive set of rules on liquidity, but instead to ask questions regarding liquidity management to ensure that the companies are aware of the risks and are monitoring them.

The American Academy of Actuaries' Life Practice Council made risk management issues such as liquidity risk management one of its major topics in 2000. The Academy formed the Life Liquidity Work Group to respond to the needs of actuaries who are concerned about liquidity risk and may be working on liquidity plans, policies, procedures and/or models, as well as to assist the regulators who are examining this risk. I chaired this Work Group, and John Murray and Laura Rosenthal co-chaired the group. A report issued by the group is available on the Academy website, *www.actuary.org*. Much of this article is excerpted from this report.

What Is Liquidity Risk?

Liquidity risk is inherent in the financial services industry, and one must understand, measure, monitor, and manage this risk. Liquidity risk is the risk that, at some time, an entity will not have enough cash on hand to meet its legitimate cash obligations. The most striking example of loss due to this risk is a run-on-the-bank event that causes an institution to fail. This type of event hit banks during the Depression when too many customers demanded to have their money paid immediately in cash, and the demand exceeded the cash reserves. Less dramatically, smaller losses can occur when a company has to borrow unexpectedly or sell assets for an unanticipated low price. The liquidity profile of a company is a function of both its assets and liabilities. Liquidity risk is inherent in the financial services industry, and one must understand, measure, monitor, and manage this risk.

There are different levels of liquidity management. There is day-to-day cash management, which is commonly a Treasury function within a company. There is ongoing cash flow management, which typically monitors cash needs for the next six to twenty-four months. The third category of liquidity management addresses the stress liquidity risk, which is focused on the catastrophic risk.

It is important to recognize that stress liquidity risk management is distinct from asset/ liability management and capital management issues. It is therefore not generally covered by actuarial opinions and is not included in risk-based capital; rather, it is a separate and fundamental area of financial risk management.

Possible Sources of Liquidity Risk

Unexpected demand for liquidity may be triggered by

- A credit rating downgrade
- Negative publicity, whether justified or not
- Deterioration of the economy
- Reports of problems of other companies in the same or similar lines of business

Other random fluctuations in demand for liquidity and certain company-specific characteristics can amplify liquidity risk. However, these characteristics by themselves may or may not cause liquidity failure. Good liquidity management can significantly reduce that risk. Examples of company-specific characteristics that can contribute to liquidity risk exposure include:

- A single or a few contractholders control large sums of money (policies or contracts). Institutional-type products are the biggest risk in this respect, although in retail lines, a small group of agents and/or brokers may control large blocks of business, and that poses a similar risk.
- The size of the company may limit access to capital markets. If a company is too small, it may not have the funding choices available to larger companies. On the other hand, if a large company is forced to liquidate billions of dollars of assets at once, the marketplace may not be able to absorb the volume at fair value.
- Immediate demands on cash. Any immediate demand for a cash payment can be a risk if cash is in short supply. An unpredictable cash demand is a larger risk. If a funding agreement has

a 7-day put option, the issuer has only one week to collect the cash needed to satisfy the obligation. A predictable cash demand is less of a risk. A well-managed company can structure its assets in such a way so that it has enough cash to cover the known obligation. So, for example, large GICs with fully predictable payout dates and no surrender provision should have minimal liquidity risk in a well-managed company because the cash flows are predictable and planned for.

- Unpredictable deferred or deferrable demands on cash. Any unpredictability of cash demands increases liquidity risk. However, the longer the deferral period, the smaller the risk. For example, a surrenderable GIC contract may have a 90-day delay provision, which under normal circumstances gives the company a reasonable amount of time to access its liquidity sources.
- Insufficient ability to borrow short term through bank lines of credit, commercial paper, etc.
- Lack of diversity in either the liability or the asset portfolio when analyzed by product, region, industry, creditor, etc. An over-concentration of illiquid assets, such as real estate or thinly traded securities, may be especially risky.

In the case of General American, the event was triggered by a downgrade. The contributing factors to liquidity risk were large funding agreement contracts held by relatively few, sophisticated customers; and these funding agreements had 7-day put options in them, i.e., the cash outflows were unpredictable and had short time horizons.

The Stress Liquidity Risk Management Process

The keys to reducing the stress liquidity risk are product design, portfolio strategy, systematic monitoring, and prepare- dness to act. Communications and coordination through a strong corporate oversight function are vital in a multi-line environment. It is essential to monitor the asset/liability liquidity risk continuously and to have the mechanisms for action (for example, deferral rights) aligned closely with the liquidity needs timeframes.

Once a company has a portfolio strategy in place and issues products with appropriate designs, it must routinely monitor the liquidity risk and be prepared to act if necessary. All of these components can apply to the business unit level and to the total company, and it is up to the company's management to select the level, the timing, and the tools that fit its business model.

Some Tools To Measure Stress Liquidity Risk Exposure

In order to determine a company's exposure to liquidity risk, a set of measurement tools should be selected and then applied to the company's portfolio. There are no simple formulas that work for all companies, but the basic tools that the industry uses can be classified into two groups: cash flow modeling and liquidity ratios. The following sections presents an overview of these tools. It should be kept in mind that these are the monitors of a company's risk profile. They should be kept current (modified as the business changes) and re-run periodically and can be used for a business unit or an entire company.

Cash Flow Modeling

While cash flow projections are often used for asset/liability matching and surplus testing, the projection mechanisms can be modified to examine liquidity exposure as well. Cash flow modeling starts with projecting all known cash flows, such as asset maturities, interest payments, and liability payments (including expected benefit payments and contractual GIC and funding agreement maturities). These cash flows can be projected for a short or intermediate length of time, depending on how they are to be used. New business flows can be estimated and added if desired.

A sophisticated model can then undergo various shocks to see where the largest cash mis-matches may occur. The modeler can assume that various options will be exercised at various times on both the asset and liability flows. Using appropriate option models can be helpful in this exercise.

Results of these tests can warn management of potential cash shortfalls. Management can then put an action plan in place to reduce the risk, depending on its likelihood and its proximity in time.

Liquidity Ratios

Liquidity ratios are a commonly used tool to assess a company's liquidity risk. The concept itself is fairly simple. For a given point in time, liquidity-adjusted assets are divided by liquidity-adjusted liabilities. If the resulting ratio is greater than some target number (>1), then the company can feel fairly confident that its exposure to liquidity risk is acceptable. If the resulting ratio is too small, the company will want to take steps to reduce the risk. For example, the assets or the liability mix may need to be restructured.

In order to determine the value of the liquidity-adjusted assets and the liquidity-adjusted liabilities, appropriate "haircuts" must be developed and applied to the book values of assets and liabilities. These "haircuts" should reflect company specific sales (and redemption) practices with relevant experience if possible. It is important to understand the assumptions underlying the "haircuts" in order to correctly interpret the result.

Conclusion

It is important for companies to focus on liquidity risk management. The risk affects a company's creditworthiness as well as its total balance sheet composition (assets in light of liabilities). The key to managing liquidity risk is to ensure that the company constantly monitors liquidity in an appropriate manner, keeps channels of communication open, and acts promptly to avoid situations of extreme liquidity risk.

Since the management of liquidity risk can be complex, it is helpful to get an understanding of how the principles of liquidity management can be used in actual circumstances. The Academy report gives examples of companies' approaches to liquidity risk management. These may be useful for companies that are developing their own liquidity plans. It is likely that a number of actuaries will be asked to assist in the liquidity risk management process in the near future.

Financial Reporting Section Council — Major Projects For 2001

In an effort to keep you, the Section members, up to date with the activities of your Section, the following information is being provided. Listed below are the major projects and activities of the Financial Reporting Section for 2001. Some of the activities are ongoing, like the production of the newsletter, whereas other activities are specific projects.

A Section Council member is listed beside each activity in most cases, and as such has been assigned the duties involved with coordinating that particular activity. If you have any questions or require more information about a specific activity, contact the appropriate Section Council member.

Additional details on the seminars to be offered by the Section appear in a separate article in this issue of the newsletter.

Most of the projects and ongoing work are shown in Table 1, while all of the Section liaison activity is displayed in Table 2 below.

As you can see, the Section has quite a challenging year ahead of us, and is depending upon the support of a lot of people to make it a successful one.

TABLE 1

Projects	Comment	Person Assigned
* Examination & Education		
- new syllabus	Ensure new exam system contains	TBN
- professional development	enough financial reporting topics.	-
- continuing education	Help with financial reporting topics.	Greaton
- Course 7 Advisory Group		
* SOA Meetings		
- Spring, 2001	Sessions written and recruiting (ongoing)	Bevacqua
- Annual, 2001		Preston
* Newsletter (Ongoing)	Scheduled for 4 issues/year	Nace
* Research		
- Ongoing	Promote, review and recommend	Rogers
- Proposals from other SOA Sections, areas, etc.	RFP's	Rogers
* Web Site		
- Ongoing	Promote and improve member communication	Poorman
* Seminars		Kitsos Rogers McLaughlin Greaton Manning

TABLE 2

Projects	Comment	Person Assigned
* Liaisons		
- Continuing Education Coordinating Committee	Exchange activities and relate back to Council	Poorman
- Finance Practice Area	Practice area liaison -- has traditionally been Chair or Vice-Chair	Shemin
- Life Practice Area		Shemin
- Life Professional Development Task Force	Will develop life practice seminars	TBN
- Academy's Financial Reporting Council		Eckman/Preston
- Academy's Life Practice Council (COLIFR)		Preston
- Section Chair Meetings	Two face-to-face meetings	Eckman

Five Financial Reporting Seminars Planned for 2001

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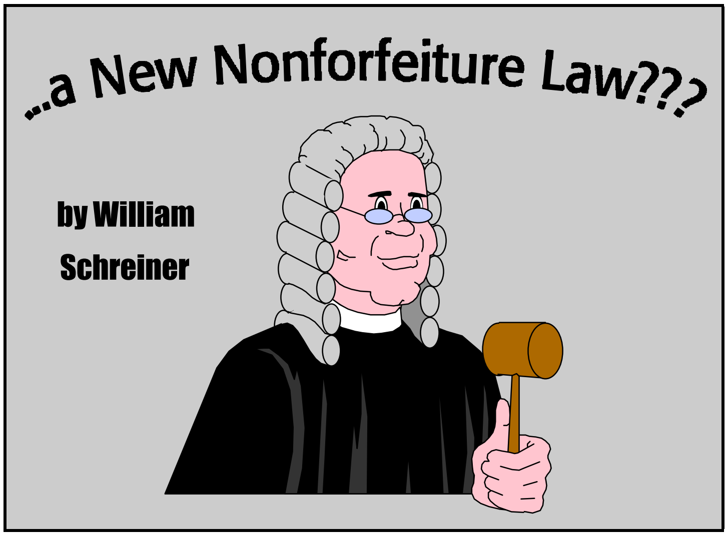


The NAIC's Life and Health Actuarial Task Force (LHATF) has been considering the development of a new nonforfeiture law for many years. The most recent effort can be traced back to the first half of the last decade of the last century. Why is getting a new nonforfeiture law (full-time or part-time) so difficult?

There seems to be widespread agreement that the existing Standard Nonforfeiture Law for Life Insurance is not sufficiently flexible to deal directly with tomorrow's, let alone today's, products.

For example, the nonforfeiture standard for flexible premium universal life products is a retrospective accumulation, rather than the prospective actuarial calculation based on standard assumptions unrelated to the premium basis of the policy that is the foundation of the Standard Nonforfeiture Law. It seems clear to most observers that a retrospective accumulation represents the best opportunity for a flexible basis that is likely to stand up to product innovation, while providing an appropriate return of pre-funded value to the policy owner.

There are two issues that have defied resolution to date. The first involves the basis upon which guaranteed nonforfeiture values should be determined; the second deals with the degree to which the insurer should be restricted with respect to non-guaranteed elements of policy value.

For guaranteed nonforfeiture values there would appear to be two prime choices for direction: specified maximum charges and minimum credits, or insurer discretion. In the context of a retrospective accumulation approach, the route of specified charges and credits means that not only are mortality and interest factors potentially, or even likely, inappropriate to the policy required, but the process is complicated further by a need to specify expense factors, which are particularly sensitive to policy specifics. On the other hand, allowing the insurer to choose the guaranteed benefits in the expectation of the market exerting discipline implies the possibility of products without nonforfeiture benefits. Clearly, such an approach would require strong disclosure standards.

Also, regulators have expressed concern over *non-guaranteed* elements, which they fear can be manipulated to the detriment of policy owners.

Anecdotes about companies lowering credits and increasing charges on a selective basis are cited. Yet, at the same time, there is common recognition of the need for an insurer to have sufficient flexibility to meet changing marketplace conditions.

Insurers point out that there is a reason that such elements are called non-guaranteed elements. For a while, a non-guaranteed element plan approach that would be required of insurers was considered, but was set aside in view of its administrative complexity and the absence of value to potential policy owners in terms of their decision-making ability.

Interestingly, the non-guaranteed aspect of dividends on participating policies has not drawn similar attention from regulators. Presumably, this reflects the historical reputation of fair play in such dividend distribution, as well as the existence today of an actuarial standard of practice that applies to such distributions. Perhaps, it also suggests the opportunity to apply a "contribution principle" to non-guaranteed charges and credits under retrospective accumulations. Such a principle applied to non-guaranteed elements would permit companies some freedom with respect to setting the level of the charges and credits, provided the elements were consistently determined among the classes of policies.

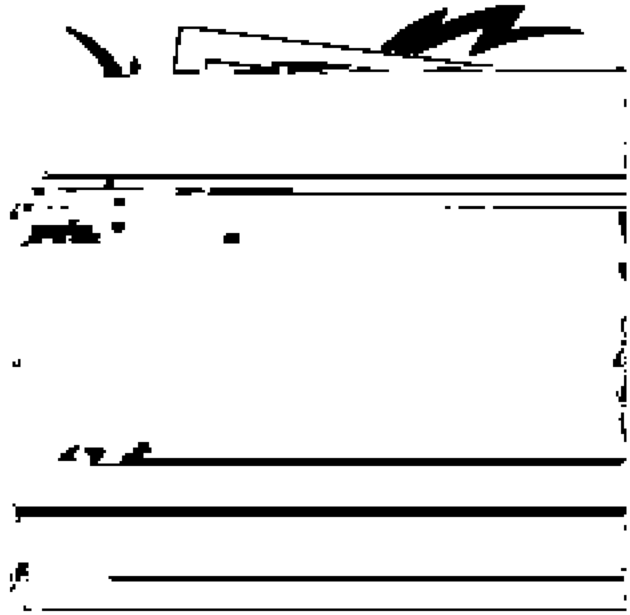
Another issue that is yet to be determined is whether any new nonforfeiture law would replace, or only supplement, the Standard Nonforfeiture Law, so that insurers could choose which law would apply to a particular policy. The virtue of the supplemental approach is that companies comfortable with the current law could continue its use, while regulators and the marketplace determine whether the new law improves upon the current situation. On the other hand, a replacement law could give regulators a measure of oversight with respect to non-guaranteed elements that does not exist under current law.

It is too soon to tell if the outstanding issues can be resolved to the satisfaction of regulators, industry, and the actuarial profession. It appears likely that, unless there is a meeting of the minds on the indicated issues during 2001, LHATF will put this issue on the back burner for the foreseeable future.

William Schreiner, FSA, MAAA, is an actuary at American Council of Life Insurers in Washington, DC. He can be reached at

Update on the Financial Reporting Section Web Site

by Deb Poorman



> *"Now, the Society has a Web page that provides access to this information and much more, all at the click of the mouse. The use of electronic communication has improved the ability of the members of the Society to communicate both with the organization and each other."*

In recent years, the SOA has taken many strides toward moving into the 21st century with regard to how it communicates with its constituents. If you think back into the not too distant past, communication with the Society was strictly via phone or what is now referred to as "snail" mail. If you needed information regarding research being done, meetings, or the favorite, exam results, you had to wait until you received it in the mail. Now, the Society has a Web page that provides access to this information and much more, all at the click of the mouse. The use of electronic communication has improved the ability of the members of the Society to communicate both with the organization and each other. Now at the beginning of this 21st century, the SOA has taken this use of electronic media to the next level. This year, each Section Council was asked to select someone to serve as a web liaison between the section council and the Society itself.

The Section Web sites were established to improve communication amongst section members and to better localize resources to make them easier to find and use. The web liaison position was described as a "point" person for a Wection's Web page. This person is not expected to do any of the technical work, nor is this person expected to come up with all of the ideas to improve the Web site. He or she is there simply to be a single contact for the Web coordinator from the Society (Debbie Jay) and the council, and to coordinate ideas for improvement. These ideas can come from the SOA, the Section council, the Web liaison, or any member who takes the initiative to make a suggestion.

Earlier this year, the SOA put forth a survey to the membership regarding the SOA Web site and the Section Web sites. The results are pending. At the Annual Meeting last October in Chicago, the Financial Reporting Section put forth a survey which included questions regarding the Section Web site. The results of the Section survey indicate that only 67% of the respondents that have visited the SOA home page have visited the Section Web site. Some of the suggested improvements included links to other resources such as regulations, research, the NAIC, and the FASB, a mechanism for online learning, and discussion forums. Some of these suggestions are more feasible than others and are being investigated. In addition to these, this newsletter is now available through the Web site. In an attempt to make the workings of the Section Council more concrete, the minutes of the council meetings have been made available also.

The Financial Reporting Section Council, the SOA Web coordinator, and I, as the Section's Web liaison, are all looking for ways to make your Section web page a better resource for you, the members of this Section. If you have any suggestions to improve communications and/or resource availability, please let us know.

Deborra M. Poorman, ASA, MAAA, is second vice president and associate actuary at Protective Life Corporation in Birmingham, AL. She can be reached at

Plans Laid for Academy's Life and Health Qualifications Seminar

Emphasizing real-world professional needs, the American Academy of Actuaries will again offer its seminar on life and health annual statement certifications in Washington DC on November 12-15, 2001.

The seminar gives life and health actuaries the opportunity to demonstrate by examination that they have obtained the necessary basic education to function as valuation actuaries under the *Qualification Standards for Prescribed Statements of Actuarial Opinion.*

> *"The primary purpose of the seminar is to provide state-specific and country-specific basic education for actuaries who did not fully meet the basic education requirements as part of their SOA examination process."*

Building on participants' knowledge of financial statements, actuarial mathematics, life insurance valuation, insurance finance and investments, and life, health, and annuity products, the 3½ day seminar will cover such topics as valuation and nonforfeiture requirements, statutory accounting, and expense analysis.

The primary purpose of the seminar is to provide state-specific and country-specific basic education for actuaries who did not fully meet the basic education requirements as part of their SOA examination process. However, actuaries seeking to refresh their basic education or add to their continuing education will find the seminar useful. Additionally, candidates for fellowship in the SOA may earn 15 units of professional development credit for attending.

There will be an examination on the final day for those seeking to meet qualification standards or professional development credit.

For more information on the seminar, contact the Academy's legal assistant, Rita Winkel, either by phone at 202-223-8196, or e-mail at *winkel@actuary.org,* or visit the Academy's Web site, *www.actuary.org/seminar/index.htm.*

Does the SOA Have Your E-mail Address?

by Thomas Nace

With the last issue of the newsletter, blast e-mails were sent to Section members for the first time, notifying them that the newsletter had been mailed, but was available for immediate viewing on the Financial Reporting Web site.

As Deb Poorman discusses in her article which appears in this issue, more electronic communications will likely take place in the future in an effort to make information more available to members on a more timely basis.

The electronic communications work if we have your e-mail address. Currently, 75% to 80% of Section members' e-mail addresses are available on the SOA Web page, *Directory of Actuarial Memberships*. We would like to improve that percentage so that any member who would like electronic communications can receive them.

> "Some members may have an e-mail address on record with the SOA, but due to a change in jobs or a change in Internet service during in the past year, the e-mail address on file is no longer current. Any updates needed can be made directly online at the Society Web Page, *Directory of Actuarial Memberships.*"

Some members may have an e-mail address on record with the SOA, but due to a change in jobs or a change in Internet service during the past year, the e-mail address on file is no longer current. Any updates needed can be made directly online at the Society Web page, *Directory of Actuarial Memberships,* or they can be forwarded to the SOA, care of *Dpedroza@soa.org.* Be sure to include your complete name!

Other members who do not have any e-mail address on file and would like electronic communications made available to them, can provide their e-mail address to the SOA in either of the two ways mentioned above.

Tom Nace, FSA, MAAA, is vice president with PolySystems Inc., Pennsauken, N.J. He can be reached at

CHAIR'S CORNER

by Mike Eckman

All of the Section chairs recently received a letter from Jim MacGinnitie requesting that each Section review the level of its fund balances. Unlike the SOA, the Financial Reporting Section and all of the other Sections do not have an objective as to the level at which surplus should be maintained. The Section Council will consider the appropriate level of surplus and what functions or activities we want to fund in order to reduce the surplus. We need the input of the membership on these issues. When the Section began, there was probably a concern that the Section would experience deficits. As the table below shows, the growth in the Financial Reporting Section's fund balance during 2000 was dramatic.

Financial Reporting Section Fund Balances

12/31/97	$210,674
12/31/98	$298,094
12/31/99	$243,662
12/31/00	$380,726

An analysis of the financial results shows that the Section's income from seminars has been the major contributor over the years. We are proud of our seminars and believe that they offer practical ways to apply actuarial knowledge. The seminars were popular from the start. The emphasis on continuing education and the need for students to obtain knowledge in subjects no longer included on the examination syllabus has added to the popularity of the seminars.

The table below gives a summary of the development of the surplus through the years. I have condensed the income and expense items into summary lines that show the net contribution.

	1998	1999	2000
Fund Balance BOY	$210,674	$298,094	$243,662
Dues & Sales less Expenses	-$29,474	-$86,572	-$24,910
Seminars	$108,315	$52,444	$111,794
GAAP Text Book	-	-$29,860	$42,014
Interest	$8,579	$9,556	$8,167
Fund Balance EOY	$298,094	$243,662	$380,727

As the table shows, the Section has been experiencing a deficit in its basic operations as its dues and sales of items other than the GAAP Textbook are less than the expense for the newsletter, publications, mailing, research projects, and the SOA's administrative charge. The $54,432 deficit in 1999 (= change in Fund Balance) includes the expense of publishing the 50th Anniversary Monograph. The seminars consistently produce income. The GAAP Textbook appears to have made a profit through 2000, but the way in which printing expense and authors' royalties are being recognized overstates the gain.

In determining the appropriate level of surplus and the disposition of any excess surplus, I think that several principles must be kept in mind. The primary one is that the surplus belongs to the members of the Section. Spending any of the surplus should benefit the Section members and should be decided on by the Section Council with input from the membership. Some possibilities include:

- Increasing the use of the Internet including:
  - Internet-based seminars
  - Web casts
  - Discussion forums
- Restricting attendance at the seminars to improve the learning experience
- Publications
- Paying some or all of the Section-related travel expenses for Section Council members
- Funding research
- Guest speakers
- Professional help with the seminars
- Contributions
- Providing benefits for Section members who live outside of North America

I have not included reducing Section dues and reducing the cost of seminars on the list. The Section dues are already low, and as the financial results show they do not cover the basic expense of the Section. Before reducing the dues, we should reduce the expenses. Also, once we reduce the dues, it might be difficult to raise them again if it becomes necessary.

The cost of the seminars could be reduced, but that may just increase demand. Based on input from those who have administered the GAAP seminars, we will restrict the attendance to facilitate the learning experience. This limit on attendance may result in lower 2001 seminar income than in 2000. It would be better to use the money to offer the seminar more often than to reduce its cost.

The appropriate level of the surplus should take into account any fluctuations in income and expense to which the Section could be subject. Some of the Section expenses are less discretionary than we might at first think. Once we fund something, there is a tendency to expect that the funding will continue, if not increase. For example, it would be very difficult to discontinue offering the GAAP seminars, as they now have a good reputation, and people expect them to be offered.

Based on the survey at last year's annual meeting, the Section membership supports our funding of research and wants us to do more. You may like to see even more seminars. Since we now work on a volunteer basis, the number of seminars we can handle is limited. Perhaps we should consider paying for some professional help to offer even more seminars.

I think that paying some or all of the Section-related travel expense would make recruiting easier and allow the Section to have more face-to-face meetings.

We have and will continue to support research and publications. We have committed to the publication of an expense monograph. The GAAP Textbook was a major undertaking for us. The expense of the textbook was about $96,000. Since the printing cost is recognized at the time the books are sold, we have additional expense of $24,500 ($7.00 times 3,500 unsold books) to recognize. Also, the financial results do not recognize the authors' royalties.

I promised Jim MacGinnitie that the Section would consider the appropriate level of surplus and what functions or activities we want to fund in order to reduce the surplus. By the time this is printed, the Section Council will have already begun discussing the issues. We want the members' input and would be pleased if you gave us your ideas. Please send them to me at my email address, *mike.eckman@reliastar.com,* or you can fax any suggestions you might have to 612-342-7033.

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