RECORD, Volume 23, No. 3*

Washington Annual Meeting
October 26–29, 1997

Session 94OF
Recent Activity of the Life Practice Council

Track: General/American Academy of Actuaries
Key words: Demutualization, Risk-Based Capital, GAAP

Moderator: ARNOLD A. DICKE
Panelists: CHRISTINE CASSIDY†
DAVID J. CHRISTIANSON
DONNA R. CLAIRE
JAMES E. HOHMANN
WILLIAM C. KOENIG
CANDE OLSEN
CRAIG R. RAYMOND
WALTER S. RUGLAND
HENRY W. SIEGEL
ROBERT E. WILCOX
Recorder: ARNOLD A. DICKE

Summary: Members of the Life Practice Council will discuss the activity surrounding their key issues, including nonforfeiture modernizations, valuation law, genetic testing, uniformity of state reserve standards, and additional projects before the National Association of Insurance Commissioners. The new American Academy of Actuaries life insurance vice president will also be introduced.

Mr. Arnold A. Dicke: We have a number of presenters because we're going to get reports from all the various committee chairs and task force chairs that we have, who happen to be at the meeting. We're going to try to get direct reports as much as we can. The panel consists of Bob Wilcox, who has already replaced me as vice president for life insurance of the Academy and Christine Cassidy who is our staff support person. We are here to try to get feedback from members and give you a report on what we've been up to in the last year.

Mr. Robert E. Wilcox: First, I haven't really replaced you. For those of you aren't aware, Christine has terminated her employment with the Academy and is here as a guest speaker

†Ms. Cassidy, not a member of the sponsoring organizations, is Director of Public Policy for AAA in Washington, DC.

after providing tremendous service to our practice council as a staff person. Steve Rentner is picking up the range as staff liaison. We will fully immerse Steve into what we're doing as we launch into this new year.

Mr. Dicke: By means of introduction, let me tell you about the Life Practice Council. The Academy is divided into practice areas and we have vice presidents for various practice areas including life insurance, health, pensions, and property/casualty. We also have a vice president that is in charge of the Financial Reporting Section Council and a vice president of professionalism. Those are the areas that are involved. The Life Practice Council is essentially a steering committee for the life practice area. As I have put it together during my term, I had the chairs of the standing committees and the chairs of the task forces and work groups, as well as members of the board who are interested in the life practice area and others who have contributed significantly to Academy activities in the life area. This is what the Life Practice Council is. If we wanted to set policy or discuss policy in the life insurance area, we did this at the Life Practice Council conference calls and tried to get as close to a consensus as we could on direction skills. So that's the role of the Life Practice Council.

The best thing to do is to start with the reports that we have. We have chairs of various standing committees to start with. I would like to ask Jim Hohmann if he would tell people what the Committee on Life Insurance Financial Reporting has been up to.

Mr. James E. Hohmann: The Committee on Life Insurance Financial Reporting had quite a busy year. There has been a lot of activity in the industry that spawned a lot of activity in our committee, as well as with proactive things that we try to do. Henry Siegel led all of our efforts around the National Association of Insurance Commissioners (NAIC) codification. Henry made sure that we had both written and oral feedback on that oral testimony on the topic of NAIC codification. We've reviewed the papers that we consider to address actuarial issues as they relate to financial reporting. If anyone wants to delve into that topic any further at some point, Henry would be a good person to talk to. Henry also monitors what happens on the Internet with respect to that as well. That particular topic has belonged to Henry and a group that he has formed within our committee. I think he has done quite a strong job on that. Almost all of our recommendations made their way into codification as we understand it today.

In addition, the Academy was called upon to form a valuation task force, and we have been contributing to that. The task force was charged with approaching valuation from a "clean sheet of paper" perspective, and the Committee on Life Insurance Financial Reporting (COLIFR) has made contributions to that task force in the form of members and is helping to produce a work product there. One of our members, Ed Robbins, is heading a subgroup that will deal with the idea of taxation.

We've given some online input into the Academy task force that was charged with studying state variations. That particular effort for us was coordinated by Dan Kunesh. Dan did a good job of going through all the materials that were put online by the task force, and he put together a subgroup to work on that on our behalf. We submitted comments in the online format. To my knowledge, all the comments have been accepted.

Another one of our members, Jim Greaton, developed a paper on the valuation of equity indexed products that I think has really helped us frame that topic. Ultimately, that topic has been taken even further by a number of groups including the group that Larry Gorski had been pulling together from time to time in Illinois to discuss those issues.

The Financial Accounting Standards Board has periodic meetings with the Academy and COLIFR members have been present at those meetings. More recently, they have asked for some education with respect to the fair valuation of liabilities. I think some of you probably recall that the Academy formed a task force that put together a paper on that topic toward the tail end of 1995. That paper is again being looked at and expanded. FASB has asked for some education, and COLIFR has suggested some team members for that. Jim Greaton, a member of COLIFR, will be one of the members of the group on the education.

Henry Siegel has been pulling together a group to revisit the question of demutualization. The Gobbert paper is being reexamined and we'll be coming out with some comment on that. Additionally, Steve Patzman has pulled together a group that's looking at the topic of developing practice notes for GAAP. That seems to be an area where we think there is some need and questions about the state of actuaries' GAAP practices in the industry. We would intend to get a set of practice notes together on that particular topic.

Finally, one of the things that COLIFR did in trying to improve communication was to partner with the SOA to include in *The Financial Reporter* something called "COLIFR Corner." It's essentially our set of minutes from our meetings that we have put together and pulled into that particular publication so that on the more immediate and more widely distributed basis, the topics of COLIFR are better known to the membership.

Mr. Dicke: I don't know if you've gotten involved in this yet, but one of the things that has been surfacing is some activity by international groups, like the new IFAA and other international accounting groups, to try to standardize accounting standards around the world. Has COLIFR been involved in that?

Mr. Hohmann: COLIFR has not been involved in that, but it was a point of significant discussion at our last meeting. Dan Kunesh, one of our members, has been tracking that very closely, and subsequent to that meeting, there have been some discussions because the Academy has had involvement in it for us.

Mr. Dicke: That could be an important development some people think. Henry, do you have anything to say about the demutualization of that work group yet? Would you like to give us a few words?

Mr. Henry W. Siegel: The only thing I want to say is we had our first meeting on October 24, 1997. It was basically an organizational meeting. The essential conclusions were that there's probably a need for a practice note on demutualization and how you set up closed blocks and how you allocate equities. In addition, there is another paper which I'll call a thought paper or theory paper, that deals with the concepts of how you deal with issues that haven't even taken place yet, such as monitoring of the closed box once it has been set up and the establishment of closed blocks under the mutual holding company act, if there's any difference, and how you demutualize a company that has been a mutual holding company already. Concepts like that are beyond the realm of what was included in the original paper. These are not yet the kinds of things you can make a practice note about because nobody has ever done it. We've had one meeting. The goal is to have the practice note out sometime in March, and the other paper will be out as soon as we can get to it.

Mr. Dicke: One of the reasons we started looking at this area was because of some comments received from people around the Actuarial Standards Board (ASB). It wasn't the standards board members who were asking. It was the people who have been working with the standards board, in particular Gary Corbett, who wrote us a letter. Are you all satisfied with the way work is going in that area?

Mr. Gary Corbett: Apart from this, the ASB or subcommittee of the life committee is working on an Actuarial Standard of Practice (ASOP). We had a meeting in New York (it wasn't a hearing or anything) and we announced it to interested actuaries. There were three or four aside from the task force. We will have a draft of that as early as the January ASB meeting.

Mr. Dicke: The things in the COLIFR report could be reported directly to COLIFR. Moving along the direction of financially oriented issues, I noticed Cande Olsen in the back, who heads up the Task Force on Life Risk-Based Capital. Can you give us a short report on what has been going on with the Task Force on Life Risk-Based Capital?

Ms. Cande Olsen: The main purpose of our committee has been to advise the NAIC with respect to making changes to the risk-based capital formula. A non-Academy of actuaries group is a group that did the original advising on the risk-based capital formula. Then it was changed from a technical advisory group into an Academy group where we have now been advising the NAIC on making changes to the risk-based capital formula. Not that many changes have been made, and the changes that we have recommended have not always been accepted, but I think that we do a good job in terms of helping the NAIC to understand the recommendations that are made by other interested parties and of helping to temper some of those recommendations.

In 1997, one of the changes will be to change the mortgage factor from 3% to 2.5% on basic mortgages, and for restructures to go from 3.5% to 7.5%, with some adjustments to that 7.5% in certain circumstances. Actually those recommendations came from another group, but a lot of research that we did helped that other group make a lot of changes to their recommendation and temper their recommendation a bit.

What we're working on right now is a new analysis of the C-3 risk. The original C-3 formula was very overly simplistic and really didn't take into account the true matching of assets and liabilities. We're working on a project now where we're taking into account, or we're piggybacking on the asset adequacy analysis. We're coming up with a lot more scenarios that would need to be used, specifically interest rate scenarios, in order to come up with the proper risk-based capital requirements. We're trying to determine how many of those scenarios are actually needed. The people that are working on that right now are Bob Brown and Mike Zurcher and Joe Dunn.

We're also working on doing a review of the C-4 risk, which is the management risk. One of the reasons why we're working on that is because it was determined that variable business was not really taken into account specifically on that risk. As a result, we decided to do an entire review of that risk. Once again, for both the C-3 and the C-4 risk, no changes will be made until 1998 or beyond. On the C-4 risk, Jim Reiskytl, Bill Wilton, and Tim Patria are working on that. We're also doing a review of the common stock factor and Tim Patria and Joe Dunn are working on that.

Mr. Dicke: C-3 is particularly interesting. Basically this would be another run of the cash-flow testing that actuaries are doing. Would the only change be the additional scenarios or would there need to be a different criterion that dictated how many have to be passed. Would there also be changes to the assumptions that are used or anything else about the cash flow?

Ms. Olsen: That's what we're looking at right now. We don’t know whether or not there should be standardized assumptions or not.

Mr. Dicke: To me this is a blockbuster thing. I don't know if anybody else feels that way, but it slips in there as a risk-based capital thing, but it basically says there's going to be another test of adequacy in the company that requires a different set and a more expanded set of scenarios to be passed. It requires perhaps standardized assumptions which our pension brothers and sisters can tell us a lot about because it has caused them a lot of trouble. We have to see how that all works out. I just want to make sure everybody understands that and see if there's anything you'd like to pass on to Cande.

Ms. Olsen: Our group has made quite a few presentations at the symposium and we have asked people to give us input, but we haven't gotten as much input as we had hoped. Normally, people don't give input until it's really starting to get serious. When you really have a recommendation that looks like it's going to go through, then people say, “What?!”

Mr. Dicke: On the other side of the coin, I think you'd probably agree from a great amount of experience in these matters that early input tends to bear proof more than input made later. I alert everybody here because this is an opportunity. It looks like everybody's happy with it, and that's good.

Mr. Wilcox: You mentioned the opportunity for early input. There is a need for additional volunteers to assist with a number of projects that we're working on through the Life Practice Council. We really have a lot of work to do, and it will be tough for us to get everything done unless we do add some additional volunteers to our ranks.

Mr. Dicke: I'd like to point out one other thing in terms of a context study thing. What you're really hearing here is evidence of an increased prominence in the role that the Academy is playing in the whole process of developing model laws and regulations at the NAIC. We've had tremendous improvement in our situation in that regard because we've been able to convince the people at the NAIC that we take a professional position and can be counted on to help them in a way that they find useful. I think the risk-based capital is an absolute model of that. That's largely in the hands of the Academy people now in terms of developing these things. This is a subject for which we can readily point to our expertise. Candy does a great job in running that group.

That gets us through a couple of our groups here. At this point, we should go to the other standing committee, which is the Committee on Life Insurance, which was recently renamed. I'll let Craig, the chair, discuss it.

Mr. Craig R. Raymond: As both Bob and Arnold have said, we have been extremely busy. I definitely think the role of the Academy as it relates to the NAIC has been heightened in the last few years, and in the current year we have been working on a number of requests for assistance from the NAIC. I'll go through the major ones which I think cover it. Guidelines 33 and 34 that we finished this year are on the annuity valuation side. Most people think of them as GGG and MMM. We were asked to provide a good deal of assistance to the NAIC on the development of these. The first one was guideline MMM, which was variable annuity death benefits, guaranteed minimum death benefit reserving. It is a project that went back a couple of years when we were asked to assist in developing the guidelines on reserving. We had a group that was chaired by Steve Preston and Tom Campbell. They put in a great deal of effort and brought together a good group of people. We worked very closely with a number of regulators to make sure we understood what the issues were as well as make sure they understood the actuarial framework that was necessary. They put together Guideline 34, which I believe is effective at the end of 1998. That has been put to bed at this point and been finished through the NAIC.

Additionally, after Guideline 33 was adopted in 1996 by the NAIC, it caused an immense amount of confusion and concerns first from the industry and then from regulators who didn't quite understand what this thing meant. Based on those concerns, we were asked to prepare an evaluation of the issues that were raised by Guideline 33, to prepare an analysis of the appropriate interpretation of it. Then we will recommend changes to clarify it, if necessary. As a result of that, a working group that was very similar to the working group for Guideline MMM, put together a revised guideline. It was based on input from the regulators to see how to make this work. I know there are still a lot of concerns raised as far as the methodology. The assistance we provided on this was to help clarify the guideline so that it could be clearly interpreted and clearly applied the way it was intended to be by the regulators, as well as to make sure it was actuarially sound. That was finished and adopted earlier in 1997 and that's also effective in 1998. Those two are done and both of those projects were chaired by Steve Preston and Tom Campbell.

The largest project or the most potentially significant one that we've been working on is the revision to the standard nonforfeiture law. The Committee on Life Insurance has had this charge for about four or five years and we have been actively working on it. We established a working group about a year-and-a-half ago and took a very specific charge from the NAIC Life and Health Actuarial Task Force (LHATF)to lay out a framework for change in the nonforfeiture law. Walt Rugland agreed to chair that working group, and he put together a very broad based group that put together a paper last year and has followed through with that paper and made presentations at the NAIC and made recommendations and explanations based on that paper as to how to implement it. At this point, there is a draft at the NAIC based on that paper that was presented. The working group also helped draft and commented on the draft of the law. There will be continuing activity working with them.

We've currently been requested to provide some input by the next NAIC meeting on what a plan would look like for a change in the nonforfeiture law. A big element to the revision to the nonforfeiture law is to move away from formulas and to move into more of a planned approach, where you lay out a plan for how nonforfeiture values would be calculated for the policyholders. We've also interfaced very closely with ASB on this, and we have a draft standard to go along with that, that would be necessary to implement it. I expect that work will be continuing. Any questions on that?

Mr. Wilcox: Several of you were at Tom Foley's session this morning and heard his explanation. It may be valuable to know where Tom is headed with that between now and the NAIC meeting in Seattle in December 1997. As many of you are aware, the ACLI has taken exception to a number of the points raised in the model that came from the Academy, as further addressed and developed by the Life and Health Actuarial Task Force at the NAIC. Right now the issue is to flush out what the ACLI is thinking about and have the Life and Health Actuarial Task Force try to work with that development. The proposed model that we're generally referring to is the July 23 draft. We'll see what sort of a compromise can be put together. Tom is putting a lot of emphasis on disclosure as the catalyst to make these kind of changes work. It will be an interesting situation between now and December to see if at least some semblance of a consensus or compromise can come out of all of this. The other alternative is that we'll have nothing other than to stick with what we have and start over with new developments. The time between now and December is a critical time on that standard nonforfeiture law issue.

Mr. Walter S. Rugland: I'd like to correct something Bob said. The Academy has been very careful to not draft the model law. The model law was drafted by the Life and Health

Actuarial Task Force. It did put in place the concepts that were in the Academy paper. The Academy paper was put together in response to a charge to tell what the consensus view is that could be the basis for a new nonforfeiture and guaranteed elements law. That was done in 1996 and the draft was prepared in the early part of 1997.

Mr. Raymond: Any questions about where the nonforfeiture project stands? Walt did a phenomenal job and put an immense amount of effort in for the last year-and-a-half by leading the working group to where it is today, drafting the framework as he said, and responding by helping the NAIC draft a model that implemented that. At this point, Walt has asked if he could step aside and let somebody else continue the charge on this one from the Academy's point of view. I've agreed that I will be leading the working group on this, at least for the time being, until I can find somebody else that can do it. For the foreseeable future, this will be under me.

The other major area that is taking an immense amount of time from our group is disclosure. We started about two years after the life disclosure was done. We were asked to provide help in expanding the disclosure law to include annuities. We have had a working group that has worked very closely providing input to the NAIC on that. This was Bob's area before he left, and in the past year there hasn't been a lot of progress because the leadership for disclosure has gone through a couple of changes since Bob left. I think there is some direction and we're starting to move forward. Tom Foley has taken over the leadership on disclosure and he's starting to focus on implementing some of the things that have been talked about. We've been asked to continue to provide input into that process. At this point, we have been looking at the disclosure issues and responding to the actuarial aspects of disclosure that have been asked to be looked at for annuities. We are specifically, at this point, also being asked to look at the implications of expanding lapse-supported, and self-supported type tests to annuities when it is necessary to illustrate annuities. We have responded on that issue in the past, and we're going to continue to respond to that issue after the next NAIC meeting and into 1998.

In addition, now that life disclosure is out there and people are living with it, we were asked this past summer to look at what problems it causes, what issues we have, what needs to be clarified, and what needs to be changed from both a company and a regulatory point of view. We are putting together a group that's going to start very quickly putting together and getting some feedback on that and putting together information on that to present. We're going to make our initial report at the NAIC meeting in December 1997, or at least we've been requested to make a report. We expect to have an initial report for that. A couple of others will be helping Roger as a subgroup of the disclosure working group to help prepare that input. That's another area that we're very interested in. Disclosure is an area in which we are very interested in getting help as well as input from people. So that's another area, as Bob mentioned, where we're looking for volunteers, and people that are knowledgeable and anxious to work. The disclosure side is an area of both annuity and life disclosure where we can definitely use some people that are willing to get involved to help us respond. We expect the life area, particularly over the next year or so, is going to end up turning into a lot of work.

Mr. Dicke: This is just an example of how the Academy functions and hopefully represents your interests. We were contacted in the course of the last year by people from the Texas Insurance Department. As many of you are aware, they were attempting to develop their own form of an illustration regulation. One thing the Life Practice Council has been real clear about is how it prefers uniform regulation insofar as possible because of the strains it puts on actuaries. We're particularly concerned about it in areas where actuaries are certifying things because it can be very tricky to certify two things that are inconsistent. We made that argument to the Texas Department, and they bought that idea that having two separate disciplined scales would put a burden on the signing actuary to justify that sort of thing. That changed some of the initial proposal. I think that was a good result. There were some members of the disclosure task force that worked on that with some people from the Life Practice Council. So we do have some successes in these areas in terms of getting out the message that actuaries are willing to help the regulators out to do their professional duty. However, there are limits, and if they're going to do that, they have to respect the needs of the profession in terms of opining on a single scale.

Mr. Raymond: On the life disclosure, as it has been implemented, we found as Arnold said, that there have been two issues that we've ended up commenting a lot on besides just what we did in Texas. It's mainly to get consistency to make sure there was one scale we were opining on. The issue that has come up the most is making sure we had flexibility as to when we set the date that we certified it. That seemed to come up a lot and we found various states and others commented on this as well, but we typically found that various states thought they were doing us a favor if they set a specific date by which you had to do it. On the other hand, if I can do it whenever I want, that would be the most flexible thing. Most states agreed and said they didn't think of that. They thought they were doing us a favor. We've been keeping an eye on that, and as Arnold said, one of the major chores is as things get implemented, we must look at our role as making sure that the actuaries are able to perform their duties. We must remind the states of the places where, if they make changes, it makes it more difficult for the actuary to do his or her job. I think we've done a good job of that.

The other significant area that we've spent a lot of time on is equity-indexed products. We had a fairly broad request from the NAIC to educate, as well as to help identify actuarial issues with equity-indexed products. Donna Claire took over the task force on that. Donna has done a phenomenal amount of work on this thing. Steve Preston has been the vice chair of this.

Ms. Donna R. Claire: This is one of the areas for which we asked for volunteers and we have over 50 people on the Academy task force for equity-indexed products. We have been doing at least quarterly reports to the NAIC. A typical report runs over 100 pages. The request was, where actuaries have to have input, could the Academy say what we should be doing? We determined that actuaries have a lot to say on a lot of issues. These issues included nonforfeiture, guarantee funds, a description of products, taxes, the SEC, risk-based capital, and basically reserving, accounting, and reinsurance. At one point, on a conference call, we had 38 actuaries arguing about reserving, which was very entertaining. We even had people hang up on the call. We wanted and we received varying viewpoints. The work is not done. In December, we're going to try to come up with our final report, and significant work has been done by a number of people.

Larry Gorski was a member of our group on the reserving side, and he is also a regulator. As a regulator, he took some of the concepts in our report and came up with what is finally known as Actuarial Guideline ZZZ. It is how one has to reserve for equity-indexed products. It was just presented. It will actually be going out and exposed for comments now at the NAIC level. It will be part of the so-called Halloween surprise from Illinois. He will require Illinois companies to comply with this by year-end, and there are other states that have indicated that they may do the same thing. It is very important work and again the Academy has had major input. Ultimately, the regulators will decide.

Another group that is actively working right now is the SEC group. The SEC asked, in a 21-page comment letter, whether this is effectively a variable product. The Academy is now taking a position as to whether or not it's a variable product. What they're doing is educating the SEC on how the set-up works, how it's invested, and what type of law is currently covering it. Again, there have been a number of people doing tremendous work on this, and I'm very happy to be a part of it. There has been a lot of work by the Academy, and I think it has been well received.

Mr. Dicke: The reserving concepts are very interesting. There have been practical kinds of approaches, but I'm fond of saying that equity-indexed products are, in effect, liability-side derivatives. In a sense, the actuarial profession's entree into derivatives is in an area that we can control. We tend to control the liability side more than the asset side. It's a very interesting subject, and what we come up with here will be very critical to the way we're perceived and how we move ahead in this new area. Great work.

Mr. Wilcox: I'm afraid many of the problems with the equity-indexed products are going to be outside the scope of what we can control. It is so difficult to adequately disclose to the consumer what's happening, that most of our problems will ultimately result from that particular area. It will not be easy for us to make sure that the products we develop and reserve, however adequately they're reserved, are properly understood.

Ms. Claire: This is one area where we actually came up with the concept of balancing language. If you say you have a product that can earn 14%, you also have to disclose, that you can also wind up with the minimum of 3%. Effectively, if you are going to say something good, you also have to tell the consumer about the downside. You can't just present one side. Again, the Academy's point of view on this is that one of our major constituencies is the public. The public does deserve to have the best possible information, and the actuaries are on point with this, especially because of the illustration actuary concept.

From the Floor: Is anything being done about the equity-indexed life illustrations?

Ms. Claire: Anyone signing as an illustration actuary has to comply with the illustration regulation. Right now the products out there are pretty basic on the life side, and typically only guarantee that equity-indexed participation for the one year. It does make for an interesting test to see how one meets all the requirements of support, non-lapse support, and self support. However, we've been able to demonstrate that products out there so far, comply, but again this was a major area of controversy and it's actually one that we have to continue to work on as products become more sophisticated on the life side.

Mr. Dicke: Any more questions about equity-indexed products? Any more questions for Craig on the activities of the Committee on Life Insurance?

One other committee that I chair for the Life Practice Council is the Practice Notes Committee. We do have several new practice notes out. The illustration practice notes for 1996 just received Academy approval. The 1997 ones are out under our forum, so by 1998 that may get through the process. There are two more practice notes that are in some sort of draft form that are available from the Academy. One is a note on equity-indexed products and that was headed by Tom Campbell. The other is on variable annuities. Actuaries have been getting a lot of questions from regulators as to how or when to do asset adequacy testing on variable annuities. We have the first draft of a practice note, and this is available from the Academy on specific questions on what type of testing is needed for these products to comply with the standards of practice and the current laws and regulations.

Mr. Dicke: Practice notes are compilations of current practice and not subsidiary standards. They simply describe practice that's going on currently, usually in the areas where there are specified approaches in standards. These things usually come out when there has been a standard or a regulation and people feel the need to know what the current practice is among the topics.

All of them are supposed to say there could be other ways of approaching things besides what is described in the practice note. It's just a description of the current practice that's known to a group of people who are writing the practice notes, so keep it in context.

One of the areas where we have been very active in the last year has been the Task Force on Genetic Testing. We have Dave Christianson here to give us a quick report on some of the things that have gone on in that very exciting area.

Mr. Dave J. Christianson: The Task Force on Genetic Testing has really been focusing on two areas. One is establishing a presence in the whole debate, and the second is to help develop solutions and stimulate people to find solutions. In establishing a presence, we really can't be at all the legislative type arenas where this is coming up and where some input from the actuarial profession might be needed, so we've developed a risk-classification issue brief, which came out in February 1997. There will be a testing issue brief that should be published in November 1997. That will then be distributed fairly widely and be available to various audiences. We have been involved in several symposia in conjunction with the annual meeting of the American Association for the Advancement of Science (AAAS) and the American Bar Association (ABA). We've been quoted in some articles on the subject. At least I think the word is getting out with regards to an actuarial viewpoint on it.

In terms of looking for solutions, we have been assessing research options with The Foundation. Arnold and I were at the University of Wisconsin at Madison with Jim Hickman to discuss some options with some of the faculty and other actuaries. Some good ideas came out of that. We participated with someone from the University of Houston who has some ideas. I don't know if we'll keep participating with him, but at least we have some interesting ideas.

Mr. Dicke: The Anderson Foundation has put out a corporate paper and that will be on the subject of genetic testing and actuarial science. Jack Turnquist came to us asking for ideas, and I know that among the conversations that led to this was one that Bob Wilcox and I had at one of the board meetings. We have been at least involved with it, not directly as an organization, but more or less personally. The fact is that the thrust done by the task force is why any of these things are happening because they're the ones taking the initiatives.

Mr. Christianson: A symposium next March is going to have a paper on antiselection, which really gets at the heart of the matter for genetic testing. I think some thought is being stimulated about focusing on the really small group of people that will be disadvantaged by genetic testing results that are negative. At the same time, the whole general public is really quite a fearful about genetic testing. To try to deal with that, we are trying to encourage research that would look at the various diseases. BRCA1 is a genetic test for breast cancer, and there is also hemochromatosis and others that get mentioned quite frequently because of the mortality implications. We've been discussing how we might get at some of those things, and I think we're going to look to collaborate with geneticists. We are going to approach the Ethical Legal Social Issues (ELSI) arm of the human genome project, and try to collaborate on some research efforts here. I think that maybe we can move this thing forward to look towards collaborative solutions, rather than having clashes. That's the general direction we're taking. Once we get this issue out next month, I think we can really focus on the research.

Mr. Dicke: You might note that genetic testing is right at the top of the list for the Life Practice Council. We think this is a critical issue, and we are very indebted to David and his state variations task force for carrying the ball for us on this. It will be one of the most important things that we do.

There are two other task forces that we have that we need to report on. Is there anyone here from the State Variations Task Force? Donna, why don't you come up and tell us what has been accomplished.

Ms. Claire: Shirley Shao has really led this effort. The specific issue to actuaries is when you're signing your name on those appointed actuary certifications with each state, you are signing that the reserves meet the minimum aggregate standard in any state. This has been a really tough thing to do, especially in smaller companies that do not have a large actuarial staff. Shirley has put forth a major effort in terms of first, educating the regulators as to what the problem is. Second, she has indicated what the possible solution is. A proposal has been developed. Frank Dino of the Life and Health Actuarial Task Force and a regulator for Florida has suggested changes to the Actuarial Opinion Memorandum Regulation to incorporate a number of Shirley's ideas, including that the actuary would only have to certify on their own home domestic state's reserving requirements. Right now, a calculation of some sort would have to be done in conjunction with the codification standards. What are the total reserves of the company compared to what they would be under codification? There are still some discussions as to what's going on there.

In addition, any regulator still has the opportunity to ask for the reserves to be recalculated, but if this goes through, most actuaries would go back to the old rules of making sure they comply with their own state. Again that also means that asset adequacy testing has to be done if it's a Section 8 company, etc.

There are other changes within this regulation. The Academy takes no position on the Section 7 exemption. The tests were changed a little bit, and right now the proposed changes will also say that any company who is doing a Section 7 opinion has to do a gross premium valuation. This regulation also incorporates some of Larry Gorski's ideas about the executive summary. If the interest rate curves are inverted, you have to check on a normalized basis or the so-called New York 7 or the NAIC 7. It is a major change to the Actuarial Opinion Memorandum Regulation. Unfortunately, that also means that it has to go through the approval processes. Shirley's work is just about done. Right now she's commenting on the proposed changes, but once that happens, there are all sorts of approvals needed at the NAIC level. Every single state would also have to adopt it. It will still be several years from now before this process can come to total completion.

Mr. Dicke: We finally get to the task force that was mentioned earlier by Jim Hohmann and that's the one that's taking a fresh look at valuation laws. That one was under the able guidance of Bob Wilcox, who can report on it before taking over the whole thing.

Mr. Wilcox: I'm going to give you a brief report and an invitation. We're going to have a full session devoted to a discussion of the work of the valuation task force and the direction that it will take us in the future.

There are a few things that I think may be of interest to you in looking at this. Many of the comments, such as Donna's discussion about the state variation, sort of get subsumed into this whole process of reexamining valuation standards. A new term that you can perhaps start working into your vocabulary is a Unified Valuation System (UVS). One of the things that we have achieved consensus on in the task force is the idea that there should be one valuation system that can provide the necessary information to all of the various publics or audiences that we serve in providing valuation information. It is also unified in that it deals with both assets and liabilities in a consistent fashion. These are our underlying basic principals that we think are absolutely critical to the overall success of a valuation system. We really are looking at a valuation system that can carry us into the next millennium and deal with the charge that we have as actuaries, which is measuring the financial viability of the enterprises with which we deal.

Viability is very high on the list of things that we're considering. We'll be looking at not only a formulaic valuation process, where we follow the rules with bright line tests that give us specific answers. We certify more to the arithmetic than the adequacy of the process. We think this is a dramatic step. Some of you may have picked up copies of some tables that we're going to talk about in detail at another session. We will talk about three specific objectives that the task force has concluded need to be met. The first of these is a viability measurement. This is not valuation in a sense of providing information to regulators necessary to determine the statutory solvency of insurance enterprise; rather, it provides information to management and the board of directors about how they can determine the viability of the enterprise with a view to the company's business plans. That doesn't mean that we can ignore the needs of the regulators. There is still the need for a trigger mechanism to identify to regulators when it is necessary that they go to court and seek the authority to assume some control over the insurance enterprise. It's necessary that we provide the sort of information that is equivalent to the current measurement of statutory solvency.

In addition, we have many other audiences who look at the results of our valuation products that are looking to determine whether or not they should invest in the enterprise or they are looking at it from the point of view of profitability from one accounting period to the next. That's also information that we intend to provide.

We are dealing with several different valuation systems to meet the various needs of statutory accounting, GAAP accounting, and tax accounting, as well as provide information to management on ongoing viability. It is the consensus that the unified valuation system should be a system that can provide the necessary information to all of those needs. That doesn't mean that there's only one number that's required for each of those needs, but rather that the system should be able to provide the necessary information and the understanding around that information that would satisfy all of those requirements. It's an exciting project to develop. We have been working so far to develop broad conceptual statements. We're presenting an interim report to the NAIC at the December 1997 meeting in Seattle with an eye to determining where this will go next. If the NAIC says that we're on the right track, our report will include a number of next steps that need to be taken to flush this out and put it into a context where it can actually be applied. We will be anxious to get the response back from the NAIC to know where we should go forward with this.

Mr. Dicke: This is the life practice area, but I will point out that the blank sheet of paper, as far as we know, isn't limited to just life insurance.

Mr. Wilcox: That's true. If you're dealing with any contingent event and the financial impact of that contingent event, the valuation process should really be independent of what the event is. We should be able to measure it, so it makes sense for us to have a consistent approach across the various disciplines. Since the charge came to us from the Life and Health Actuarial Task Force of the NAIC initially, our focus started out looking at life and health, and we've tried to keep both of those firmly in mind as we've gone forward. By June, the NAIC indicated that we should give some consideration and evaluation of its impact on property and casualty. We have tried to also pay attention to its impact on the property and casualty area, although it is not with the same level of success. We will be giving that more attention in the future, with an eye to ultimate consistency across the various disciplines in the way the valuation process is conducted.

Mr. Dicke: Are there any comments on the valuation task force? There's another session where there will be detailed reports given from various subgroups. I'm going to make a request of a person who is here, even though I gave no advance warning. We do have Bill Koenig here who is from the Life Committee Standards Board. Is there anything going on that you'd like to call this group's attention to, Bill?

Mr. Wilcox: This past year Bill has chaired the Life Practice Committee of the Actuarial Standards Board (ASB) and has turned that over. He's now a real member of the ASB.

Mr William C. Koenig: The Life Operating Committee has spent most of the year trying to wrestle with the nonforfeiture proposal. It is not at all just a nonforfeiture proposal. It is a wide-ranging global sort of proposal involving disclosure of company intentions and plans. We are trying to read the minds of future generations of management as yet unborn. It brings into its scope the management of nonguaranteed elements of all sorts. It makes what I have been used to thinking of as guaranteed nonforfeiture values, nonguaranteed, which some might think is a step backwards. That’s sort of an off the cuff comment. We have been trying to wrestle with this proposal on the Life Operating Committee and we are trying to be constructive as far as supporting the Actuarial Standards of Practice (ASOP). There is the same sort of difficulty that we had here with the illustration work, where there is heightened sensitivity, especially here where you're dealing with pricing matters. You are as close to the heart of antitrust concerns as you can get, and we want to be careful to be within both the spirit and the letter of the antitrust rules, and we want to be careful that the regulators write the prohibitions and not leave a lot of loose ends, expecting the ASB or its Life Operating Committee to limit behavior.

Thanks largely to the efforts of Roger Wiard-Bauer and Frank Irish, we have a draft of a standard of practice. It is in its most preliminary stages. The tension is between a law and a standard that is so prescriptive. The plan is written and management loses all its control over managing the block of business. There is sort of an auto pilot approach whereby you might think that variable products are in that mode. The market goes up, the values go up and if the market goes down, the values go down and it's about that easy. Applying that to traditional business or any sort of fixed business is a challenge. There is tension between that approach and the one that says management should have some freedom to manage a business and react to events that are not only unforeseen but unforeseeable, such as losses on other blocks. How can this be done in a way that is acceptable to the regulators who want a plan and want it written down and want it adhered to one, two, three? We wrestled with that, and there's some disagreement already on the Life Operating Committee as to whether the draft that we wrote is too prescriptive or too lenient, so I guess we're not done yet.

That has been the main focus of what we've done over the year. Earlier in the year, we revised *Actuarial Standard of Practice 15* on dividends to comply or to make it more consistent with the new illustration regulation. I hope the ASB will adopt that before the end of 1997.

Mr. Dicke: We basically have gone through my list of the issues that the life practice area has dealt with this year. There are a couple of things about the way the practice council or the practice itself is being run that I think might be of interest. Christine, I thought you might want to describe the key public policy issues brochure that everybody received.

Ms. Christine Cassidy: Every year the Academy puts together the key issues brochure. This is the work of all the practice councils. Starting on page ten, there is an exact listing of each of the practice councils and what the councils have determined as their key issues and ongoing priorities. These distinguish where the priorities of the work fall. The key issues are something hopefully forward looking into 1998; it is what either the NAIC, the state legislators, or members of Congress will have on their plate. Ongoing priorities tend to be tasks and projects that are more ongoing in nature, and are things that might have more importance to the actuarial profession instead of the public, which is where the key issues are.

This brochure is really a calling card for the Academy. It's a communication product that we use when we are working with members of Congress, congressional staff, and some of the other trade organizations that we work with in Washington, DC and at the state level. It explains the role of the Academy and the value that Academy can add to these various projects. Sometimes when you meet with Capitol Hill staffers, and you say you're with the Academy of Actuaries, people wonder what an actuary is or what actuaries do or can do. This brochure does an excellent job of explaining what the actuarial profession can do in terms of issues that can affect the public. This starts on page four and five and lists some of the federal issues, and then page six gets into a lot of work before the NAIC.

Mr. Dicke: If anyone does have input on what you think our key issues should be, I know Bob would like to have that. This is really where our budget gets spent, so it's important to us as members from that perspective. You're supplying us with the budget, and you have a right to give us input as to where it should be spent.

The final thing that I have on my list to talk about is the fact that we reorganized the standing committee. In the past we've had two standing committees—the Committee on Life Insurance and the Committee on Life Insurance Financial Reporting. The Committee on Life Insurance focused more and more on state issues and some of the other practice areas have specific state issues and federal issue committees. We decided that we wanted to make that a structure within the life insurance practice. Right now, the number of federal issues is somewhat limited, but it's likely that we're going to see more federal interest in the life insurance industry and in the things that life insurance actuaries are interested in. For example, you heard from Dave Christianson about the number of things that are going on in genetic testing, and there are several federal bills, as well as state bills related to genetic testing. In some respects, some of the most threatening bills are at the federal level. It's entirely possible that part of the problem is that federal legislators and regulators are not as familiar with insurance as the state regulators are. Some of the concepts there could be very detrimental to the whole risk classification process. In any case, we feel a need to get involved in that arena and be sure that our voice is heard.

We have prepared a response to one of those bills, which was offered by Representative Kennedy and would basically have prohibited genetic testing defined so broadly that it probably includes family history, certain cholesterol testing, and so forth. It didn't define disability. It probably means all insurers in the property/casualty area. We did write a response to that. That's an outlier bill that is not likely to pass this time around, but it's something to be concerned with. That's an example.

Another example of the interest in federal agencies is that the Government Accounting Office had a group of people around discussing risk-based capital, various types of financial institutions including banks, securities firms, and insurance companies. Cande, Bob, and I met with them. There were two separate meetings. One time Bob and I met with these researchers, and another time Cande and I met with them and gave them an idea of what we do regarding risk-based capital. They were also interested in the appointed actuary opinion and wanted to know if someone was willing to sign about the adequacy of assets in the life insurance industry. They said they didn't think anybody would be wiling to do that in the banking area.

We had a presentation at this meeting sponsored by the Smaller Insurance Company Section, and the topic was banks. There was the chief counsel of the controller of the currency, and she was explaining some of the relationships of banks to insurance. One of the points we had been trying to make, not only through our group, but also through the Financial Reporting Section Council, is that there has been testimony to the point that we're not advocating state or federal regulation. We're not advocating any position as to whether banks should or shouldn't be in insurance, but we are advocating that those who sell insurance or produce an insurance product should be held to the kinds of standards that actuaries have found are useful in making sure the company will be able to fulfill its promises. We think there is an actuarial issue there and we've made it clear to these people I mentioned.

These things are cropping up on the edges and we're sensing more of that. That's the reason for establishing a federal issues committee. The other part of that is that there will be charges for the Committee on Federal Life Insurance Issues and the Committee on State Life Insurance Issues. The Committee on State Life Insurance Issues will now have a clear charge to be the communicator of all of our positions to state regulators, and they interface with state regulators on these issues. That is what has been happening anyway. It has put the seal on that process.

The Committee on Life Insurance Financial Reporting retains essentially its previous mission. In fact, the Committee on Life Insurance Financial Reporting has a line to the Financial Reporting Section Council, and there will be more and more things in that area, such as the international issues that we talked about. That will be a larger and larger part of that committee's mission in the future.

Mr. Wilcox: You can see with the number of issues that Arnold talked about, that there's not always a clear line between federal issues and state issues. With the work that David is doing on genetic testing, it perhaps has a raised profile as we look at a bill like Congressman Kennedy's bill and the impact that could have. That doesn't mean that the issues at the state level go away. In fact, last year there were bills issued in 31 jurisdictions dealing with genetic testing and various issues surrounding underwriting and using genetic information. That's going to be in both areas. We will have a good deal of ongoing back and forth between all three of these committees to make sure that the issues are adequately addressed. Sometimes we will put a particular issue in a committee more from a point of view of keeping the work load balanced than we will from a point of view of the clearest, but we'll try to make the fit clear as well.

There is one other task force that I ought to mention that completed its assignment this last year and passed on its recommendation to the board of the Academy. That was the Task Force on Insurance Solvency. This committee did an admirable job of identifying the fact that insurer solvency was not quite the right issue in that regard, and it came back with a recommendation with regard to insurer viability. The board accepted, in it’s report, that all of the work of the various committees in the Academy, where it is at all appropriate, will consider the work of the insurer's viability and the dynamic financial condition analysis approach to determining insurer viability. The task force itself has completed its work, but the issue remains and will be a high priority for all of our other committees as they work during the coming year and beyond.

Mr. Dicke: In terms of the connection between these two things, you might recognize from what Bob said, the valuation task force is literally taking the dynamic financial condition analysis approach and making it a part of this unified valuation system. The recommendations may come down in this one. This may be something you want to get a head start on because it's coming along. We're not talking about having these reports to regulators. They are reports to management, and nevertheless are part of the system that we think ought to be in place for valuing liabilities and making sure the company is viable.

There hasn't been too much comment. I hope we can take that to mean that we've done a good job in representing the members' interest for the year. There has been a lot of activity. If you have an interest in any of the areas we've mentioned, write down the area of interest and give it to Steve Rentner and he'll make sure that the committee chair knows about it.