



SOCIETY OF ACTUARIES

Article from:

The Financial Reporter

December 2008 – Issue No. 75

The Month That Could Never Happen

by Henry Siegel



Henry W. Siegel, FSA, MAAA, is vice president, Office of the Chief Actuary with New York Life Insurance Company in New York, N.Y. He may be reached at Henry_Siegel@newyorklife.com.

Nothing that happened in September could ever happen. We knew that. After all, in June we knew that ...

- Goldman Sachs would never become a bank holding company.
- Merrill Lynch would never be bought.
- USC would never lose to Oregon State.
- AIG would never go bankrupt.
- We are all alone in the universe.

OK, the last is from the movie “Men in Black” but you get the point.

I first ran into “never” while reviewing GIC pricing for Equitable in the late 1970s. We were told quite convincingly that interest rates would never go over 10 percent, and certainly never over 12 percent. And we all know how that turned out. The bottom line is: nothing economic is ever impossible and Murphy’s Law always applies.

These days, whenever I’m told that something could never happen, I always remind the person delivering that message that never is a very, very long time. I feel the same reaction when I’m told that something like the sub-prime collapse is a 1-in-200-year event. After all, 200 years ago, the United States only had 17 states. Something that happened yesterday might happen again as soon as our memories fade.

In general, tail-risk is much larger than our models often show.

Let’s move on to international developments.

JULY AND AUGUST

These were pretty quiet months. Vacations mean that major decisions are put off. In fact, if I didn’t combine the two months, I might not have mentioned August at all!

On July 9 the U.S. Securities and Exchange Commission (SEC) held a roundtable on fair value accounting. Sam Gutterman represented the Academy on the second of two panels. To the best of my knowledge, this is the

first time that the Academy has ever been represented on an SEC roundtable. The specifics of the comments at the roundtable are reported elsewhere. In general, however, most participants thought that fair value was still a good measurement attribute for securities in the kinds of market we saw this year. The interesting part of this is that by September, SEC Commissioner Christopher Cox was admitting that fair value accounting contributed to some of the turmoil we’ve been seeing.

The other development in July was that the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) discussed revenue recognition one more time. They more or less agreed on using customer consideration as the basic method for recognizing revenue. Unfortunately, they also agreed not to adjust for acquisition costs. If applied to insurance, this would result in large losses at issue, similar to statutory accounting. They were also not able to agree on the circumstances for unlocking the revenue allocation.

Finally, in September the Board decided not to scope out insurance from the revenue recognition project. However, no one has yet figured out how the customer consideration will work for annual premium products or products with unlimited benefit periods. More will be heard on this in months to follow.

SEPTEMBER

On September 3–4, the National Association of Insurance Commissioners’ (NAIC) E Committee and its International Solvency and Accounting Working Group (ISAWG) held a joint meeting to kick off its Solvency Modernization Initiative (SMI). After a day of listening to comments from the industry and the Academy, the members met in private for the second day. At the subsequent NAIC Fall Meeting, the NAIC announced seven items have been added to the ISAWG charge as a result of SMI:

- 1) Compare E.U. and U.S. solvency regimes, prepared by a consultant.
- 2) Study international solvency regimes to assess which/whether to incorporate aspects into the U.S. system.

- 3) Develop a document synthesizing all current NAIC regulatory principles.
- 4) Invite international regulators to give presentations to the NAIC on solvency developments.
- 5) Develop a document with critical solvency issues by October 15.
- 6) Charge the statutory accounting principles working group with comparing International Financial Reporting Standards (IFRS) to U.S. Statutory Accounting dealing with differences and implementation issues
- 7) Staff will organize an educational session on international developments at Life and Health Actuarial Task Force (LHATF).

In short, the NAIC has decided that it needs to take international developments seriously. In particular, it is very aware that if IFRS replaces US GAAP, it will once again be faced with the choice of either using IFRS for statutory accounting or doing a Codification 2 to replace GAAP with IFRS. At this point, no decision has been made on which option to elect.

On September 18, the IASB had its first discussion of insurance topics in several months. The specific discussion was an educational session on using Contract Fulfillment Value (CFV) as a measurement attribute for insurance contracts. In brief, CFV says to use entity specific assumptions for all measurements except those for which an active and deep market exists. This was largely in agreement with comments made by many with respect to last year's Discussion Paper.

Some in attendance seemed to have difficulty understanding this proposal and the conversation went in a variety of directions. No decisions were reached at this meeting, but we will be addressing the topic again in the near future.

NEXT QUARTER

In October, the IASB will again discuss measurement attributes for insurance in an educational session. On November 10–11 there will be an insurance working group meeting for the industry to give the Board input on the same issues.

In short, the NAIC has decided that it needs to take international developments seriously.

The International Actuarial Association (IAA) will have had its semi-annual meeting in Cyprus, November 1–4.

The NAIC will have the educational session for LHATF some time during the quarter and its Winter Meeting will no doubt continue to discuss international issues.

In Memory of Dan McCarthy

Dan McCarthy, FSA, MAAA, EA, died on September 26. Among the many posts he held, Dan was the international secretary of the Academy and was largely responsible for organizing the U.S. profession's response to international issues. He will be greatly missed. An extensive obituary is available on the SOA Web site at <http://www.soa.org/about/membership/2008-deceased-mccarthy.aspx>.

Remember: Insurance accounting is too important to be left to the accountants! ■