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Chairperson's Corner

By Rob Frasca

The need for financial reporting actuaries to be able to communicate effectively has never been greater.

The 2011 annual reporting period has challenged actuaries to communicate financial results and the risks to future performance from an extremely difficult economic environment. Insurance companies depend on financial reporting actuaries to articulate clearly to management the messages contained within their reported numbers. Without such communication, management outside of financial circles will remain unclear on where the company stands and on the business directions to pursue.

The need to communicate effectively is not just a necessity for internal management purposes. The ability to communicate financial reporting issues and to interpret financial results may be even more critical when dealing with external audiences. As the forces advocating regulatory change intensify, financial reporting actuaries must communicate with regulators to ensure a clear understanding of the implications of regulatory change before it is enacted. Also, in a difficult economic environment, where investors are reluctant to commit capital to ventures that are in any way risky or uncertain, it is imperative that financial reporting actuaries be able to represent effectively the risks and rewards of the industry in a manner in which those with little background in insurance can understand. This communication is critical to attracting the steady flow of capital that the industry desperately needs.

Two recent developments have focused on actuarial communications. The first is the explosion of disclosure requirements associated with various financial measurement regimes. The disclosures required under fair value reporting in US GAAP as well as the requirements contained in IFRS 7 are just two examples that immediately come to mind. Ironically, however, the increasing volume of disclosure requirements, introduced in an attempt to clarify results, may have the unintended consequence of clouding the picture through the overwhelming heft of the information presented. Here is where the financial reporting actuary must cut through the clutter and communicate what all the information means in a clear and relevant manner.

A second development is the adoption of Actuarial Standard of Practice No. 41, "Actuarial Communications." Effective for most actuarial communications made after May 2011, the standard places new requirements on how actuaries present information to their audiences. In addition to requiring more complete disclosure of the sources and methods used to arrive at actuarial conclusions, the ASOP places obligations on actuaries to take responsibility for the data and assumptions that go into their work, even if such information is provided from external sources dictated by the actuaries' clients. Now that this standard is in place, financial reporting actuaries would be well-advised to track the range of practice that emerges.

It has been a long held view that the market capitalizations of insurance enterprises are significantly below those of other enterprises. While this observation may be understandable when interest rates are low, it is one which predates today's difficult economic environment and has dogged the industry for years. Many industry observers point the blame at the opaqueness of insurance accounting and the difficulty in interpreting financial results. This trend shows no indication of decreasing any time soon. The development of more complicated financial measures makes it even more difficult for outsiders to understand the messages contained within the numbers. The current capital measures in the United States along with the complexities of

US statutory and GAAP reporting (think AG 43 and fair value measurement, for example) are difficult enough to interpret. Now, layer on emerging capital measurement techniques, Solvency II and the proposals under IFRS and US GAAP, and the challenges of communicating what the numbers mean seem only to be growing greater.

This is where the financial reporting actuary has the opportunity, indeed the obligation, to shine. Calculating the numbers is difficult to be sure, but the value of the financial reporting actuary is in interpreting and communicating the results to the external audiences who have no interest in, and no patience for, the arcane methodologies used to determine them.

The obligation to communicate effectively does not stop with internal company management, nor within the investment community. It extends beyond the industry into areas where the general public could benefit from an understanding of the financial issues facing the insurance and financial services industry and general economy as a whole. In his address at the Society of Actuaries (SOA) Annual Meeting, SOA President Brad Smith challenged all actuaries to become more visible in commenting on the key issues facing society and in helping people to understand our unique perspective. Financial reporting actuaries are in a position to contribute to the understanding and resolution of some critical issues around the health and viability of the life and health insurance industry in today's difficult economic environment. In order to do this, financial actuaries must focus on clear and accurate communication of the meaning of the numbers that they calculate and to seek out opportunities to discuss financial reporting issues with people outside our usual audiences.

The current economic environment and the emerging financial reporting developments make the interpretation of financial issues facing life insurance companies more difficult than ever. At the same time, the variety of parties needing to understand these same financial issues continues to expand. As financial reporting actuaries, we are uniquely qualified to contribute to the communication of financial aspects of the life and health insurance business and to improve the general understanding of issues facing our industry. We have an obligation to communicate effectively. Are we up to the challenge? ■

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