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TO BE CONTINUED

Editor's Note: This is another in the series of articles from the Committee on Continuing Education. The rule is one article to one subject to give the non-specialist in that subject up-to-date general information and to encourage further research in the subject if the reader is so minded. Comments will be welcomed by the Committee and by the Editor.

The Efforts of the ALC-LIAA Joint Actuarial Committee

by John M. Bragg

Readers of *The Actuary* may be interested in current efforts of the Joint Actuarial Committee, ALC-LIAA, because those efforts may have an important influence on operations of life insurance companies in the United States, and because professional services of actuaries will be needed to implement certain changes which are proposed.

Representative of the membership of the two trade associations, the Joint Actuarial Committee was created in 1966. Nine actuaries are on the parent committee and an additional 11 on the subcommittees.

An objective of the committee is to bring about certain changes in the Standard Valuation Law and the Standard Non-forfeiture Law, where such changes *appear to be* called for and are in the public interest. The very high level of interest rates currently available and expected for many future years suggests a need for change. The committee now proposes that the maximum permitted rate for valuation and non-forfeiture be raised from the current 3½% to 6% single premium individual and for group annuities, and to 4¼% for annual premium annuities, all life insurance and benefits supplemental there-

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SATURDAY'S CHILDREN

Table of Expected Working Life For Men, 1968, by Howard N. Fullerton, June 1971 issue of Monthly Labor Review.

by A. M. Niessen

This table (hereinafter referred to as the BLS table) purports to provide up-to date information on working life expectancies of men in the American population. It is based on labor force participation rates for 1967-69 and life table functions from the 1968 U.S. Life Tables for males. Among the areas of possible usefulness of the table the author includes estimates of lost earnings in court cases dealing with indemnity for loss of life or permanent injury.

In the opinion of this reviewer, the BLS table cannot provide a basis for a reasonable estimate of loss of earnings for court cases. First, in any case of that kind the employment status of the individual in question is definitely known, so that rates of belonging to the labor force are totally irrelevant here. Second, the BLS definitions of "being in the labor force" makes it impossible to distinguish clearly between the retired and the non-retired in the late middle and older age groups. Such a distinction is obviously of paramount importance for a sound estimate of future income from work. It is only a properly chosen service table that can provide a basis for such an estimate.

Ideally, the service table should reflect as closely as possible the experience of the group of which the deceased or injured individual was a member. Another advantage of a service table is that it permits an estimate of the value of employee benefits which would have become available to the individual in the ordinary course of events.

This reviewer is also skeptical about the usefulness of the BLS table in such areas as "establishing occupational replacement needs" and "establishing pro-

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REALISTIC FINANCIAL REPORTS

by Kenneth R. MacGregor

Editor's Note: We are indebted to Mr. MacGregor and to the Life Office Management Association for permission to reprint the following address on a timely subject. This address was delivered at the 1971 Annual Conference of the LOMA.

Having regard for the theme of your Conference—*Effective Management in a Changing Society*—it seemed to me that I could most appropriately speak on "Realistic Financial Reports." It goes without saying that effective management is impossible without them and most of my experience has involved the realism or otherwise of financial reports. Furthermore, I doubt whether there is a livelier subject at present than "adjusted earnings"—the question of realism in life insurance financial reports. If you have been confused by the publicity and controversy on this subject, you are not alone, and you may well ask:

- Have actuaries and regulatory authorities been too conservative in preparing financial statements?
- Have the public and management been misled concerning the "real" earnings of life insurance companies?
- Are accountants trying to "take over from actuaries?"
- Do "generally accepted accounting principles" apply to life companies?
- What is the nature of the changes now being pushed by the advocates of "adjusted earnings"?
- Are the proposed changes desirable?

Before expressing my views on the subject, I should like to disclose any bias that may be inherent from my background.

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The Actuary

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AN EDITORIAL BY THE PRESIDENT

WE are often reminded that the dictionary definition of actuary is "a registrar or clerk" (presumably in the sense of the word as it was used centuries ago) or "an expert who calculates insurance risks and premiums." The actuarial profession has sought to update and extend this definition in a number of places, such as the booklet of our Public Relations Committee, "The Actuarial Profession." It might be a worthwhile project for this committee to convince the publishers of dictionaries that a new definition seems called for.

In our attempt to describe more fully the scope and extent of the work of the actuary, considerable emphasis has been laid on his role as a business man and executive. Although it is quite true that many actuaries have used their mathematical and analytical abilities and backgrounds as a foundation for engaging in managerial and executive work, I believe that we should not underemphasize our mathematical expertise.

Certainly, the informed public looks upon actuaries as being involved in various types of mathematical analysis involving insurance, pension plans, and the like. We should, of course, always make it clear to the public that we do not merely make calculations or look into glass globes to predict the future, but rather that the fundamental aspect of our work involves the theory and the assumptions underlying the actuarial computations and, going beyond this, the design and implementation of the various insurance programs involved. Thus, for example, the question asked frequently by laymen as to whether electronic data processing systems will "put actuaries out of business" can be readily and satisfactorily answered in the negative.

The danger of considering actuaries as being primarily business men, rather than their work being founded on mathematical ability and training, is that this leaves open the door for others, who are not properly qualified, to venture into the actuarial field. This is all too evident in the current scene. The accountants are attempting to set up their generally accepted principles so that they (at least on paper) will have the ultimate authority in deciding whether proper actuarial methods and assumptions are used in the valuation of both pension plans and insurance companies. Although our Guides to Professional Conduct imply that we as actuaries should have complete professional independence in this area of our unique qualifications, perhaps thought should be given to strengthening them in this respect.

Then, too, currently there seem to be certain problems arising in connection with the actuarial work required for developing and maintaining private pension plans. For several years, an organization consisting primarily of pension sales people and insurance company agents has been operating and soliciting members under the banner of being "pension actuaries."

If the primary characteristic of an actuary is to be a business man, then we will have difficulty in defending our unique status. But if we rely on our mathematical foundation (as to ability, education, and experience), we should readily be able to convince one and all that not everybody who has a good knowledge of accounting practices or of pension design and maintenance is an actuary. We must be aware of our obligation to the public and make it very clear that, in certain areas of the insurance and pension field, only qualified actuaries can perform the necessary services. Similarly, we should recognize that there are other areas where actuaries can perform services, but where other technical people can also be useful. Thus, we must be certain to define clearly both the areas of work in which the actuary alone should have responsibility and authority and, in other fields, those areas in which others, too, can perform satisfactorily.

Robert J. Myers

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to, and all health insurance. At the same time, the committee proposes the adoption of two new annuity mortality tables —the 1971 Individual Annuity Mortality Table (1971 IAM) and the 1971 Group Annuity Mortality Table (1971 GAM).

The appropriateness of higher interest rates is certainly underscored by the current portfolio net earnings of companies (5.30% for 1970, according to the *Life Insurance Fact Book*). Net new money interest rates, with which the 6% proposed for single premium annuities is comparable, are much higher. Furthermore, the annuity surplus strain, resulting from gross premiums based on new money rates and reserves based at 3½%, appears to be a major problem, even for the largest companies.

At an early stage, the committee concluded that it would be necessary at the same time to suggest new valuation mortality standards for annuities, because of the dramatic improvement in annuitant mortality. This has resulted in the two new papers recently distributed. We are all indebted to the authors—Harold Cherry, in the case of the 1971 Individual Annuity Mortality Table, and Harold Greenlee and Alfonso Keh, in the case of the 1971 Group Annuity Mortality Table, and to all the other members of the annuity subcommittee, for the highly professional and dedicated work shown by these papers.

The insurance subcommittee examined the question of whether a new mortality table would be needed for life insurance, and concluded that a new table would not be needed. This conclusion was based on the fact that improvement since the 1958 CSO Table was developed is far smaller than has ever been used in the past to justify a new table, by the fact that recent mortality has levelled off, and by the belief in some quarters that insured mortality may show some tendency to increase in the fuutre.

The most controversial aspect of the committee's work turned out to be the interest rate that would be proposed for life insurance. Rates advocated in the industry ranged from 3½% (i.e., no change) to 5%. Reasons for an increase, apart from general desirability based on

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portfolio earnings, included the deficiency reserve problem, the inequities to persisting policyholders resulting from too high early cash values, the desire to bring statutory earnings more in line with "adjusted earnings," and the desire, resulting from insolvency fund legislation, to prevent a company from becoming technically insolvent on a statutory basis while remaining solvent in fact.

Several arrangements were considered, including temporary changes in the law. Deliberations in the Joint Actuarial parent committee finally boiled down in the range of 4% to 4½%, with the compromise choice of 4¼% finally winning out. That rate was unanimously adopted by the committee and is now regarded as a fine solution to the problem. It is the belief of the author that it has nearly universal support in the business, a characteristic which is certainly necessary. The next order of business involves discussion with the National Association of Insurance Commissioners, and with the actuarial profession generally.

Readers will also be interested to know that several other changes in the standard laws were suggested to and considered by the committee, including the repeal of deficiency reserve requirements, the alteration of expense allowances, and the abandonment of the cash value floor for reserves. However, no changes along these lines are being proposed.

Readers will also be interested in a new and more recent project of the committee, for which a subcommittee has been appointed. This is the determination of new statutory minimum capital and surplus requirements. It appears likely that the committee will come up with such new requirements but, even more importantly, with a "game plan" approach for new companies (and possibly for some other companies), which will seek to prevent future insolvencies. This entire project, which is very fascinating, is entirely the outcome of certain recent proposals for insolvency legislation, which would require solvent companies to make up the deficits of insolvent ones. □

Financial Report

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I was graduated from university as a mechanical engineer. However, the onset of the depression induced me to become an actuary. I spent 35 years in Federal supervision of insurance companies and several other kinds of financial organizations in Canada. I am not an accountant and have no professional training in that area. Nevertheless, I have analyzed many a financial statement, especially of life insurance companies, and have been a pallbearer or funeral director at several corporate funerals.

Although I am reluctant to strike a sombre note so soon, this would seem a good time to say a word or two about dealing with companies in their death throes. Unfortunately, not all insurance companies are blessed with eternal life—notwithstanding the optimism of the proponents of "adjusted earnings."

It is a very serious matter to decide when euthanasia is indicated. A company should carry on as long as possible as an independent organization but must not continue to the point where another company cannot take over the business without loss to the policyholders. Many supporters of "adjusted earnings" allege that regulatory authorities are primarily interested in the balance sheet in order to determine solvency, whereas accountants, management and investors are primarily interested in the earnings of the company as a going concern. I would say that regulatory authorities are, or ought to be, vitally interested in both the earnings and the balance sheet, because the trend is usually as important as the position at any point in time.

If the business of a company must be taken over, one can never find a purchaser (sometimes loosely called a reinsurer) that will accept assets at values other than their current market values—certainly not at amortized cost or any other "artificial" value. As for unamortized acquisition costs, any suggestion that some value should be placed upon items of this nature is invariably treated with utter scorn.

Consequently, in the evolution of the form of financial statement for life insurance companies on this continent, moneys spent for things or purposes not having a realizable value in an emergency (for example, a company's charter, commissions and advances to agents, medical and inspection fees, etc.,) have been charged off as expenses when incurred. Undoubtedly, these expenditures are made in the expectation that they will be recouped in subsequent operations. However, that will be so only if expectations are substantiated by events. What might be termed "fair-weather financial reporting" permits one to imagine that such expenditures are made gradually over the period of anticipated return. In my opinion, realistic financial reporting requires one to wait and take credit for such reimbursement only when it is realized.

This is the crux of the current debate. Accountants, notwithstanding their supposedly conservative attitude, take the optimistic view, affirming that in accordance with "generally accepted accounting principles," expenditures should be matched with revenue over the period of anticipated return. Regulatory authorities and most actuaries have taken the more cautious approach of charging off expenditures when incurred. To be fair, I must add that actuaries have evidenced a degree of division within their own ranks, but it seems to be mainly some of the younger actuaries who side with the accountants. I would suggest to these enthusiasts that if they experience adversity over extended periods they will see more merit in the conservative approach.

In my view, there has been nothing wrong with the accounting—it has been quite realistic. Facts have been faced and the system has worked well. It has kept a rein on advocates of "growth at any price." I do not believe that anyone has been misled. However, I do believe that many will be misled as a result of the current proposals to "adjust" earnings so as to defer the burden of acquisition costs.

It is, of course, obvious that current practices will reduce earnings as long as a company is writing enough new business to keep it above a static state. The fact that in issuing a new policy more money usually has to be spent or put into reserve than is received by way of premium in the first year has always puzzled many people (including directors) unfamiliar with the technical aspects of the business. There has long been a feeling that there must be something phony about this situaton, or something wrong with the accounting which produces such a result or, if not, that something should be done to relieve the surplus strain of new business.

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