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WHERE HAVE ALL THE EARNINGS GONE?

by George L. Hogeman

The effect of changing from statutory to GAAP accounting is to reallocate from one year to another the earnings which a particular block of business generates. A change in accounting cannot affect the inherent earning power of such a block, other than to the extent that a portion of the earnings is consumed by the accounting process itself. An objective of a good accounting system is to report earnings correctly in total and to allocate them correctly among the years.

The AICPA guide for stock life insurance companies specifies that a company changing from statutory to GAAP accounting must restate its earnings of many prior years. This results in the reallocation to prior years of what would have been earnings in future years. These transferred earnings were not in fact reported to stockholders in these prior years, since the insurer was then using statutory accounting; neither will they be reported in future years, since all blocks have been changed over to the GAAP basis. Thus, the stockholders and the investing public have not had and will not have these transferred earnings reported to them. Therefore, the long-term earning power of the insurer is substantially under-reported.

A hypothetical example will illustrate the principle. A block of current issues is assumed to generate earnings over ten years. The value at issue of the earnings of this current block is 46, whether the accounting method be statutory or GAAP. The table shows each set of earnings year by year, the excess of statutory over GAAP year by year, and the remaining excess at the start of each policy year.

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FAT CATS MEOW!

A survey of 15,000 executives showed that fat executives received less pay . . . and are less likely to advance as quickly as lean persons.

New York Times

by Milton J. Goldberg

At the invitation of the Editor of *The Actuary*, I welcome the opportunity to discuss this New York Times report. The Editor evidently envisions this response as a natural sequel to my 1940 Discussion of the Paper, "Relations Between the Average Amount of Insurance per Policy and the Height and the Weight of the Insured" (RAIA XXIX).

At the very outset, one must challenge the premise itself, because: (1) the fat executive statistics are round figures, and (2) the fat executive obviously carries more weight than the lean executive and, therefore, is entitled to the greater pay because of the added dimension he gives to his work.

It is conceivable, of course, that in the case of the fat executive—as compared with the lean executive—the fat head allows relatively little room for the brain, causing him to be narrow-minded. On the other hand, there can be little doubt that the fat executive operates on a broader base, whereas the thin executive — being more incisive — immediately comes to the point. A fat judge, for example, by sitting too long on a particular case, is well-equipped to suppress the evidence contained in the big briefs enveloping him. Irrespective of the specific case involved, the end is always in sight.

It may be that the fat executive—not unlike Uncle Sam in this respect—is in poor fiscal shape due to lack of sufficient excise.

As a result of Women's Lib, more and more females are applying for executive

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MEDICARE COST ESTIMATES AND EXPERIENCE

by Robert J. Myers

Note: Mr. Myers recently appeared before a Congressional Committee Panel on Medical Care Costs and the Impact of Health Insurance thereon and discussed the Medicare Cost Estimates and the resulting experience. As Chief Actuary of the Social Security Administration until 1970, Mr. Myers had the responsibility for preparing the actuarial cost estimates for the various proposals for Medicare and for the Medicare program after it was established. We are glad to publish his comments to the Panel.

Medicare Cost Estimates and the Resulting Experience

In the many years during which the proposals that are now the Medicare program were under consideration, great controversy centered around the question of what the cost of the hospital benefits would be. Such costs, for purposes of simplicity, can be said to be constituted by only two elements: (1) the average daily cost of hospitalization (including room-and-board charges and all other hospital services, such as operating room, drugs, x-rays, and laboratory tests), and (2) the hospital utilization rate (days of hospitalization during a year, averaged out over all insured persons).

First, consider the average utilization rate. This element is, to some extent, an over-simplification, since proper actuarial analysis requires consideration by age and sex. The medical economists who, in the early 1950's, had primary responsibility for the development of the cost assumptions believed that the utilization rate would be only about 2 to 2½ days per capita per year. I studied the relatively sparse data then available for persons aged 65 and over and, after making

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EXAMPLE
Earnings of Current Issue Block

Policy Year	Statutory	GAAP	Excess of Statutory Over GAAP	Remaining Excess
1	—43	11	—54	17
2	17	9	8	71
3	16	8	8	63
4	15	7	8	55
5	14	6	8	47
6	13	5	8	39
7	12	4	8	31
8	11	3	8	23
9	10	2	8	15
10	9	2	7	7
	—	—	—	—
Total	74	57	17	
P. V. at Issue	46	46	0	

Next, it is assumed that business issued in prior years has been following the same earnings pattern except that each year's volume has been showing a compound growth rate of 8%. The reported earnings for the current year will then be:

Statutory Earnings	43
GAAP Earnings	46

However, in changing over to GAAP, all in-force blocks are changed over and, therefore, the amounts in the column "Remaining Excess" will not be reported as earned in future years. The stockholder who might have wanted to sell in prior years did not have these transferred earnings to make his stock more valuable, and the stockholder who may want to sell in the years ahead will not have them to rely on either. The amount of these never-to-be reported earnings in this particular hypothetical example is 271, which is six times a single year's earnings.

A different technique of handling the transition would have avoided this substantial under-reporting of long-term earning power. The different technique would have, at the point of transition, left old issues to run off on the statutory basis and applied GAAP accounting only to new issues.

Should a mutual company adopt GAAP accounting, it would under the AICPA method of handling the transition find itself paying dividends out of surplus, rather than out of earnings, for many years after the transition. □

SETTING GROWTH LIMIT

The Midwest Population Center in Chicago reports that more insurance programs are paying for vasectomies, with the amount ranging from $40 to $140. The clinic charge is on a sliding scale, based on income and the number of children already in the patient's family, with a top charge of $150.

—*Employee Benefit Plan Review*

A brazen example of the Law of Supply and Demand. The clinic charge is on a sliding scale, based on income and the number of children already in the patient's family. Obviously, the charge varies directly with the number of children in the absence of Universal National Health Insurance, but inversely under a Universal NHI plan.

(*Courtesy of Ack-Ack*)

Actuarial Meetings

Mar. 18, Chicago Actuarial Club

Mar. 20, Actuaries' Club of Des Moines

Mar. 20, Seattle Actuarial Club

April 11, Baltimore Actuaries Club

April 15, Chicago Actuarial Club

April 17, Seattle Actuarial Club

COST COMPARISON IN MARYLAND

by Ralph E. Edwards

A Bll recently introduced into the Maryland Legislature was sponsored, supposedly, by a sales representative of a certain life insurance company noted for its high average size policy and quite competitive products. The Bill would require the Insurance Comissioner to publish a price comparison for all life companies licensed in Maryland. The financing of the entire project was to be divided among the companies in proportion to premium income. It clearly seemed to be a move for the local agent to get rather valuable free advertising for himself and a few other companies. This was the topic discussed at the January meeting of the Baltimore Actuaries Club.

From a different source the proposal might seem consumer oriented. For all we know, other legislators sell insurance and the proposer never expected the Bill to get anywhere. If so, it is a poor joke at the taxpayer's expense.

In deciding what was involved in intercompany comparisons several notes were made. (1) It may or may not be fair to use the same method for par and nonpar companies. (2) the usual cost method fails to point out that non-participating insurance is almost invariably cheaper if you die soon and more expensive if your death is long deferred. In fact, these two aspects are necessarily interrelated if all other things are equal. (3) Keeping comparisons up-to-date is vital if each company is to be treated fairly. (4) More than one type of cost comparison seems desirable since not all policyholders surrender after 20 years. (5) The company (and not necessarily the actuary) determines the dividend scale. (6) Comparisons should be based on the company's current dividend scale and projected dividends should not be permitted. (7) Companies operate in varying markets. In some the persistency is high and mortality is low. In others the reverse is true. Most companies operate at least slightly in both markets. (8) These considerations are ignored by the consumerists. (9) Whether it is proper for a company to sell the same product in both high cost and low cost markets. (10) Whether demagoguery in this area is more evil than any result it professes to correct. □