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VLI—THE ANSWER TO A MARKETING DILEMMA?

Richard Johns (with consultation by Richard Stillinger), *"The Life Insurance Industry's Marketing Dilemma,"* pp. 40; Argus Research Corporation, New York, N.Y. 10005.

by Walter N. Miller

Remember the early days of variable life? To anyone who was involved with this product (and there were many, many such people in those days), it was really exciting. Our paper stimulated a massive outpouring, unmatched in recent memory, of truly high-level comment and discussion. No Society meeting seemed complete without a concurrent session and a workshop on some aspect of VLI. Other meetings and seminars proliferated. Hotshot representatives of (supposedly) hotshot brokerage firms set up lunches and other entertainments to get a leg up on handling the projected billion dollar separate accounts. Reporters called all the time, then wrote wildly inaccurate stories in which the only real truths were quotes from top insurance executives about what a revolution was in store for the industry as the fantastic new VLI product gathered momentum.

And now, only eight years later, now what? One (and only one) of our major competitors has VLI on the market. I get five letters a year (at most) from our agents asking when we might also. I answer them by saying we would like to have a good deal more indication of real interest on the part of agents and the public before we make the large commitments needed.

What happened?

A lucid, interesting recounting of VLI's history and outlook, replete with thought-provoking opinions of many insurance industry people as well as author Richard Johns and the Argus Re-

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Calling All Part 4 Authors

The Society of Actuaries is seeking an author for a new textbook in contingencies for Part 4 students. Although several very able persons have already expressed an interest in writing the book, the Society wishes to make this opportunity generally available to all qualified persons. A formal proposal will be required of each prospective author. Information and specifications may be obtained by calling or writing to: Warren R. Adams, Director of Education, Society of Actuaries, 208 South LaSalle Street, Chicago, Illinois 60604, Telephone (312) 236-3833.

ICA

ZURICH LAUSANNE

21st INTERNATIONAL CONGRESS OF ACTUARIES

From June 19 to June 26, 1980, there will be an International Congress of Actuaries in Switzerland. The first three days, Thursday to Saturday, will be in Zurich with a special celebration on Saturday in honor of the 75th anniversary of the Association of Swiss Actuaries.

Sunday and Monday will be spent on excursions and travel from Zurich to Lausanne, where the Congress sessions will resume on Tuesday. The farewell party will take place in Lausanne on Thursday evening.

Reports will be requested from all national actuarial organizations represented at the Congress on the subject of "The Training of the Actuary." There

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ON THEORIES ON GAAP CONVERSION

by Clayton A. Cardinal

To begin the discussion, consider this question: Does GAAP have the sustaining power to survive the current attacks against it? Some readers may have seen the March 15, 1977, issue of *Forbes*. The cover byline reads:

Accountants' Report

To the directors and stockholders:

We have examined the Consolidated Balance Sheet of the company and consolidated subsidiaries as of December 31, 1976 and 1975. In our opinion, these financial statements present fairly the financial position of the companies, in conformity with generally accepted accounting principles consistently applied.

On the other hand, there is a growing body of opinion that holds that our opinion is not worth a damn.

Such captions cause one to wonder why any company, except under legal compulsion, would want to convert to GAAP, at least not until after the *current* controversy on objectives of financial reporting is resolved.

Conversion to GAAP is an expensive undertaking which cannot be justified without some associated derivative and meaningful value to a company. The circulation drafts of the Financial Accounting Standards Board on objectives of financial statements have been described as advancing asset and liability accounting with present value measurement. If GAAP, as currently applied with its inherent revenue and expense matching principle, were to be abandoned in favor of asset and liability accounting, then any company which would now convert to GAAP might very well have to convert subsequently to

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Theories of GAAP Conversion

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some other accounting system in the near future. Prudence would dictate that a decision to convert should be delayed if at all possible until a decisive position is taken by the Standards Board on objectives of financial statements. As evidenced by the potency of the controversy itself on financial statement objectives, can we really know in many parts what it is to which we want to convert? If we cannot, then we can have only theories of conversion. Eventually, we hope, the Financial Accounting Standards Board, if it wants to survive, will tell us what the objectives of financial statements are. When it does this, and does it correctly, we will no longer need conversion theories.

An important reason why GAAP is criticized today is that many of its principles are inconsistent with economic principles. Economic principles are *the* principles upon which companies are managed. Companies are not managed on GAAP principles. As a consequence of this inconsistency, the financial statements reported currently in compliance with GAAP do not fairly present in many important ways the financial performances of companies. The statements therefore do not completely meet the needs of general investors and creditors for making economic decisions on the companies. Consider some examples:

(1) GAAP forces recognition of loss but defers profit recognition.

(2) So-called "goodwill" is written down when in many instances *its value* is increasing.

(3) Because GAAP in many parts does not reflect economic considerations, so-called purchase accounting also conflicts with economic principles.

(4) GAAP deferred taxes are determined without recognition of the value of money. Moreover, no attempt is made under the Phase 1 tax to match taxes to revenue for life insurance companies.

(5) GAAP would have us believe that general investors and creditors have different objectives in "contracting" with mutual companies than they have in "contracting" with stock companies, and therefore that the objectives for GAAP financial statements for mutual companies are different from the objectives for GAAP financial statements for stock companies.

(6) How would you like to put your life savings in a bank one day, and returning the next day, to be advised that your account decreased 20%? In effect that is exactly what GAAP does in defining deferrable acquisition costs by application of the so-called "related-to-and-directly-varying-with" rule.

(7) Every businessman knows intuitively, if not pragmatically, that some events are *cyclical* in nature, and therefore must be provided for in his product pricing. He also knows that if his accounting establishes no reserves for such cyclical events he will have roller coaster earnings. In this regard, when the Financial Accounting Standards Board prohibited so-called contingency reserve accounting, GAAP was again weakened. As an aside, according to the Foundation for the Study of Cycles there exists a statistically demonstrable 9-year mortality cycle. Therefore, should not mortality contingency reserve funds be permitted?

(8) In auditing life insurance companies, an important concern of auditors is the very critical long-term interest rates used in calculating reserves. Auditors, like politicians and like actuaries, do not seemingly give a second thought to the destructive consequences of economic recessions on assets, and thus the need to consider such in their valuation. Certainly, there's a moral in this somewhere.

With these examples you can understand why there exist different theories of conversion to GAAP. For what is conversion to GAAP anyway, other than restatement of statutory earnings? And when agreement among intelligent people cannot be reached on each step of the conversion process, is it any wonder that different theories exist?

What does all this mean for the company intending to convert to GAAP in the near future? It means that GAAP earnings do not just happen. GAAP earnings result from a large number of decisions, many of them compromises, by *the many people* necessarily involved in implementing GAAP in any company. These decisions (although they did not for many companies already converted to GAAP) must reflect the understanding by the Board of Directors of the financial entity which it directs, expressed either explicitly or through its chief spokesman, for example, the chairman, or the chief executive officer, but certainly not the actuary or the accountant. Financial statements should reflect the financial management decisions, and their consequences, which a Board of Directors and a company make. This is what is important to general investors and creditors.

With this in mind, the decisions to be made in implementing GAAP, or, if you prefer the theories to be adopted to the extent permitted by the various audit guides, should reflect that explicit understanding of the Board of Directors. In practical terms, this understanding translates to either advancing or deferring the recognition of earnings by deliberately determining the systems and assumptions used in converting to GAAP. □

Society Examinations Seminars

GEORGIA STATE UNIVERSITY

Seminars for Parts 2, 3, 4, 5, 7, and 9 of the Society Examinations will be held between April 3 and April 28, 1978.

Complete information can be obtained from: Professor Robert W. Batten, Department of Insurance, College of Business Administration, Georgia State University, University Plaza, Atlanta, GA 30303, Telephone: (404) 658-2725.

Letters

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rates, dividend scales, policy reserves, nonforfeiture benefits, etc. — companies should give consideration to *both* factors, as well as to possible changes in mortality (and lapse) rates. Such treatment would diminish, if not wipe out, the need for adjustments today — with respect either to the nonpar companies' premium rates and/or benefits, or the par companies' controversial "investment-year" method of apportioning dividends. There exists a definite parallelism here between the two systems of operation.

Milton J. Goldberg