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## NAIC EXAMINER'S HANDBOOK

by Lewis P. Roth

At the June NAIC meeting, the Executive Committee adopted the Financial Condition Examination Handbook and the Market Conduct Examination Handbook, both of which became effective on January 1, 1977. The purpose of the book is to update and simplify the examination process for all insurance companies.

Such examinations were recommended in the McKinsey & Company Report to the NAIC on Strengthening the Surveillance System (see *The Actuary*, January 1975). The recommendation that these examinations be conducted separately was not adopted. The examinations will be handled as a single unit and both procedure reports have been combined in a single handbook.

The introduction to the Financial Condition Examination Handbook states the following: "The basic purposes of an examination system are (1) to detect, as early as possible, those insurers in financial trouble and/or engaging in unlawful and improper activities and (2) to develop the information needed for appropriate regulatory action." The Handbook is a guide to assist State Insurance Departments in accomplishing these basic purposes. There are three key elements which this handbook attempts to systematize and they are: an early warning system, a system for scheduling examinations, and a system for planning and conducting the examinations.

In stating the procedures for scheduling examinations, a high priority will be given to (1) companies that have undergone a change in management, (2) companies that identify as "priority company" by the Early Warning System (for a description of this existing System see *The Actuary*, February 1976);

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## ACLI

These initials recognize the change from the Institute of Life Insurance to the American Council of Life Insurance. Individual copies of the following recent publications may be obtained from the Council at 277 Park Avenue, New York, N.Y. 10017. □

### *Pension Facts 1976*

This annual report is the information source for the public on pensions and other employee benefits. The booklet contains an excellent and up-to-date bibliography.

### *TAP Report 14*

This latest report in The Trend Analysis Program is on Changing Residential Patterns and Housing covering all aspects from Regional shifts in Population to Home Architecture. There is a section on Questions and Implications for Life Insurance Company Management.

### *1976 Social Reporting Program of the Life and Health Insurance Business*

This is an account of the corporate social responsibility activities of the life insurance section of the American business community.

### *Freedom and Control in a Democratic Society*

This is a report of a conference of chief executive officers of life insurance companies and academic leaders in June 1976, sponsored by the Graduate School of Business, Columbia University and the American Council. (Only a limited number of this report is available). □

## Actuarial Meetings

April 13, Actuaries Club of Des Moines

April 14, Baltimore Actuaries Club

May 12, Baltimore Actuaries Club

*Is attendance at your meetings falling off? Maybe it's because you don't send us your meeting dates to publicize.*

## SEX AND THE SINGLE TABLE

by Thomas G. Walsh

An excellent article, *Sex and the Single Table: Equal Monthly Retirement Income For the Sexes?* by Barbara J. Lautzenheiser, F.S.A., appeared in the Fall 1976 issue of the *Employee Benefits Journal*. It explains to non-actuaries the basic tool used by all actuaries — classification of risks for the purpose of determining the cost of any insurance benefit.

The article details the reasons for the actuary's classification practices and defends them. It also provides a good description of the current controversy concerning the use of separate annuity mortality tables for men and women. As the article emphasizes: the reason it costs more to pay pension benefits to females than to males is because females live longer, not because risk classifications are followed.

As Actuary for Teachers Insurance and Annuity Association, which is currently engaged in litigation because of the use of separate mortality tables, I was pleased to read this informed presentation of questions involved in this fundamental issue.

The legal and social arguments being used against risk classification are shown by the author to break down on further analysis. The legal argument is that the Equal Pay Act of 1963 and Title VII of the Civil Rights Act of 1964 implicitly forbid classification by sex. If this legal line of reasoning is followed to its logical conclusion, risk classifications for any grouping would not be permitted.

The social arguments include statements that any difference in mortality rates between males and females are cultural and hence will disappear over time. Another social argument states that many

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## NAIC Examiner's Handbook

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(3) companies that the department considers troubled based on (a) results of prior financial condition examinations, (b) results of examinations or other indicators of market conduct (c) information from other states or outside sources, (d) concentration on business in high risk lines and (e) significant changes in operating results or in the mix of business.

The Handbook puts particular emphasis on the review of other audits, internal controls, examination of computer-based operations, analysis of operating trends and a search for unusual or unfamiliar items.

The section on internal controls which includes the review of EDP based operations is very comprehensive and could be used by a company's own internal audit department for the purpose of establishing a good control system. There is also a welcome new section on statistical sampling which is quite comprehensive and, if used, could substantially cut down on examination time.

A separate section on understanding and evaluating reinsurance is included. It appears that such understanding and examination should fall within the regular program of internal controls and other checks and balances, but, for some reason, reinsurance seems to be highlighted in a special way. I wonder why?

The second part of the Examination Handbook is an entirely new approach to regulatory audits. It is called the Market Conduct Examination Handbook and it deserves high praise. As pointed out in the Handbook itself, "one of the department's major responsibilities is to reduce the frequency and the severity of insurance practices that may adversely affect policyholders and claimants in this state." Why such an examination has not been conducted in the past is hard to imagine, but I, for one, certainly applaud this type of examination.

Details concerning how the state can fulfill this responsibility by detecting problems as soon as possible and taking action necessary to minimize their practices are given as an aid to the examiner. These problems are categorized into four key areas: (1) sales and advertising, (2) underwriting, (3) rating, and (4) claims.

## ERISA and IRA

*Individual Retirement Accounts*, Actuarial Note No. 1-77, U.S. Railroad Retirement Board, Chicago, Illinois, January, 1977, pp. 6.

This note summarizes the principal eligibility conditions for individual retirement accounts under the Employee Retirement Income Security Act of 1974 including the liberalizations under the Tax Reform Act of 1976.

All employees not eligible to participate in a qualified pension plan are eligible to set up an IRA. It is interesting to note that the Railroad Retirement system is not considered a qualified plan; therefore, railroad employees are eligible for IRA's except where an employee is participating in the private pension plan of an individual railroad or a pension plan from nonrailroad employment or self-employment.

Free copies of this note may be obtained from the Bureau of the Actuary, Railroad Retirement Board, 844 Rush Street, Chicago, Illinois, 60611. □

The purpose of the Market Conduct Examination, as explained in the Handbook, is to collect information in these four key areas to determine whether action need be taken against the particular companies or whether remedial legislation should be proposed. The actual procedure for carrying out this Market Conduct Examination is also given in the Handbook and includes such items as a review of the company's marketing material with regard to whether or not the company is complying with laws and regulations regarding sales and advertising.

In the underwriting/rating area, the examiner is to look for such items as proper rate classification, proper use of exclusionary riders, unfair discrimination with respect to any particular segment of the market, and undue delay during the process of issuing the policy.

With regard to consumer or other related complaints, the company will be advised to use a complaint register and the review will consist of determining patterns which may exist among the files reviewed and assurance of compliance with policy provisions and other regula-

tory requirements. The reviewer will also examine a sample of applications rejected or declined and a sample of policies cancelled or not renewed to determine compliance. The examiner is also instructed to review the company's claims practice by line of business for compliance with statutes, rules and regulations and the company's loss settlement guidelines. A sampling of both open and closed claims files will enable the examiner to complete a coordination of benefits survey, a closed for payment or denial survey, a litigated file survey, and a draft or check endorsement survey.

Throughout the Handbook, examples of problems are given and methods of uncovering unusual items are listed.

Both Handbooks are comprehensive and should make for a more thorough and more efficient examination of the company's affairs than we have seen in the past. However, the industry and most Commissioners continue to recognize the fact that the success of any program to improve procedures will depend on well trained and competent examination personnel. The NAIC does have the power to establish standards of qualifications it will accept for Convention Examiners. A report on the Qualifications, Classifications, and Suggested Compensation for its own examiners was adopted at the June NAIC meeting becoming effective January 1, 1977. Since the need for adequate training is a basic element of the problems, discussions have been held regarding a training course to be made available for new examiners.

One final point on state examinations: the NAIC Subcommittee on Manual Revision is in agreement with the industry position that would get us away from requirements that all companies be examined on a prescribed or mandated schedule and that each and every examination be a full and complete one. The Subcommittee did not, however, accept the position of the insurance industry that the Report of Examination be short and concise.

Copies of the Handbook are available from the NAIC Central Office, Publications Department, 633 W. Wisconsin Avenue, Suite 1015, Milwaukee, Wisconsin 53203, \$30. Supplementary updates will be sent to Handbook subscribers whenever revisions are called for because of new problems or techniques. □