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THE NEW LIFE COMPANY ANNUAL STATEMENTS IN CANADA

by David R. Johnston

Out of the labors of several groups over the last seven years* a new method of financial reporting for Canadian life insurance companies came into use beginning with year-end 1978. This article describes the changes, contrasting them with GAAP developments in the United States.

The objective was the same in each country—to modify the traditional conservatism of assets and liabilities so that reported earnings would no longer differ so widely from those that emerge under Generally Accepted Accounting Principles used for other industries. The Canadian approach nevertheless recognizes the special nature of life insurance by maintaining conservative margins in the balance sheet for protection of policyholders.

Major differences between United States practice and the new Canadian procedure are: (1) the new Canadian system applies equally to mutual and stock life companies; (2) the new Canadian law does not provide specific limits on valuation bases to be used; (3) by law the policy reserves in Canada must be the same in statements for policyholders and shareholders as for statutory reporting.

The major changes introduced by the new legislation are:

(i) *Improved assumptions for valuation of liabilities*

The actuary used to have to certify that his reserves made "good and sufficient" provision for future obligations, and that they satisfied statutory requirements. Maximum interest assumptions were 3½% for life insurance and 4% for annuities, except that, if the actuary felt a higher rate was more appropriate for a block of business, he could seek its approval from the Superintendent of Insurance. The law also specified a number of acceptable mortality tables, again allowing the actuary to seek approval of another table if he desired.

Now the valuation actuary must give his opinion that the valuation assumptions used, for both existing and new business, are appropriate to the circumstances of the company and the policies in force. (Also, he must declare that the reserves make good and sufficient provision for future obligations, and are not less than reserves calculated on the minimum basis described later). The assumptions must be acceptable to the Superintendent. No interest rates or mortality tables are specified, either in law or regulations. Furthermore, the use of withdrawal rates and provisions for administrative expenses and dividend expectations are now contemplated by the law.

These changes have suddenly given Canadian actuaries much more responsibility in determining policy reserves. In anticipation of this added responsibility, the Canadian Institute of Actuaries formed a committee to study the subject.

This committee has worked from the premise that there is now a need for professional standards in the valuation of life insurance policies, and that such standards not be merely a reaction to the new legislation, but should constitute good profes-

*See Michael Rosenfelder's article, *The Actuary*, January 1976. The participating bodies were the Canadian Institute of Chartered Accountants, the Canadian Institute of Actuaries and the Canadian Life Insurance Association, with their views brought together and put into law by the Federal Superintendent of Insurance.

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EDITORIAL BOARD CHANGES

Early retirement (retroactive to December 1978) has been requested by *Colin E. Jack*, who has aided this Newsletter meritoriously since January 1975. His services to *The Actuary* are warmly commended.

Michael B. McGuinness of Toronto has joined us as an Associate Editor. Canadians, in particular, will please regard his requests for contributions as authoritative.

Charles A. Groeschell of Milwaukee is welcomed as Competition Editor. His sole occupancy thereof awaits only "C.E.'s" announcement of results of Competition Ω.

Andrew C. Webster is promoted to Editor Emeritus.

E.J.M.

ACTUARIES AND COMMUNICATION

by Linda M. Delgadillo
Society Communications Manager

The other day in the meat market, Ed the butcher asked me what kind of job I had and whom I worked for. Imagine his puzzled look when I told him, "Society of Actuaries."

"Oh," he carefully replied, "that sounds interesting."

When I asked him if he knew what an actuary was, he thought for a moment and then said, "Well, it rhymes with mortuary—is there a connection?"

"Close enough," I answered.

Then I thought a while longer about how I could explain the actuary's work to Ed. I knew he had a reputation around the neighborhood as a betting man, so I talked about actuaries in betting terms.

I said, "Well, Ed, actuaries use numbers—you know, statistics—to predict the future. They study the chances of something happening, bet on the odds,

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and then tell you what your insurance will cost."

Now you and I know there are better ways to describe the actuary's work, and we also know that actuaries are not confined to the insurance business.

But that's not important to Ed. What he understands are numbers, odds, and insurance, especially the last, since he has tried to protect his business through insurance coverage.

What an audience understands and what is important to it is the basis for communication. How to communicate with audiences like Ed the butcher, or anyone else, is in terms they can understand and appreciate.

This is one of the main goals of the Society's communications program. In trying to make the word "actuary" better known, we must reach different audiences and communicate with them in terms they feel comfortable with.

You as actuaries must do the same thing. In formal communication situations, as for example, with a new client, do your homework and know whom you are communicating with. You should try to determine your audience's technical knowledge of your work, and then decide whether you need to cover the fundamentals of your subject and which terms, if any, you must define.

You should also try to commit yourself to help your audience, and not assume that your audience understands your subject. And above all, keep your audience's convenience in mind while you are trying to get your message across.

I try to incorporate these principles in the Society's communications efforts in several ways. For example, when I send a suburban newspaper a news release announcing that an actuary has achieved an FSA, I explain what an accomplishment it is by comparing it to receiving a Ph.D. degree in mathematics.

When I answer a young person's request for actuarial career information, I talk about the study time involved, the courses to study, the types of jobs available, the outlook through the 1980's, and the salary ranges.

When I try to publicize the research findings of various Society committees, most recently the 1979 Build and Blood Pressure Study, I talk about people among the statistics.

It's not difficult to discuss mothers, wives, babies, people living, and, people dying and weave them into discussions about birth trends, mortality ratios, and marriage statistics.

Actuaries can do the same thing. Next time you speak to a nonactuarial group, like the Rotary Club, Kiwanis, PTA, or other civic groups, talk about how you as an actuary affect their lives and how your work can be responsible for the solvency of major companies.

When you talk with high school or college students, create an exciting picture of career opportunities and challenges. Behind the statistics you study are human lives. Tell young people about them and what you do for them.

Most importantly, talk about your work not only with your peers, but among your personal contacts, friends and family. Discuss what's happening in health, retirement, sex discrimination.

And above all, remember your audiences. Each one is different from the other. Show them consideration. Put yourself in their place, and determine their information needs about the actuarial profession. Then provide them with that information clearly, concisely, and coherently. □

Annual Statements in Canada

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Valuation Actuary

It is now required that each Board of Directors formally appoint its "valuation actuary". There is only one "valuation actuary" for a company, and this ensures that he can obtain the information he needs for valuing liabilities. Changes in this appointment must be reported to the Department of Insurance. The new law permits the auditor, in giving his opinion in published statements, to rely on the valuation actuary's valuation of liabilities but does not require him to do so. Most auditors express reliance on the actuary's valuation.

Conclusions

These changes in the law were intended to produce an income statement more nearly on a G.A.A.P. basis, while not diminishing the concern for solvency. It appears from 1978 statements that the amounts of income reported on the new basis have generally been increased, to between 25% and more than 100% above what they would have been. The size of the increase depends mainly on whether the old basis of reserves was net level premium or Canadian Modified, what the mix of business is between par and non-par, the amount of new business relative to in-force business, and how much of the acquisition costs have been deferred. If the amount of new business sold is abnormally low, income may actually go down, because renewal increases in reserves are higher under the new procedures.

As noted, policy reserves have generally been decreased by amounts in the range of 4% to 10%. This has produced increases in total surplus, including appropriations, in the range of 40% to 100% or more. Since there is discretion in the size of some of the surplus appropriations (e.g. contingency reserves), there has been less uniformity in the increase in reported free surplus, the range of increases being from zero to over 100%.

Many actuarial matters remain to be fully resolved, including:

- when should changes be made in valuation assumptions for a block of business?
- what are the criteria for an appropriate valuation method, particularly in provision for cash values and deferral of acquisition expenses?
- what is an appropriate margin for adverse deviations in a valuation assumption?
- how should deferred income taxes be determined and disclosed?
- what obligations of an insurance company should be within the valuation actuary's jurisdiction?

The Canadian Institute is actively trying to produce general agreement on such matters. All matters on which a consensus can be reached will be incorporated in its Recommendations for Financial Reporting. An ongoing committee will keep the Recommendations current with accepted actuarial practice. □

Deaths

Harry E. Clark—FSA 1970
E. Forrest Estes—ASA 1928
Kenneth Oldham—ASA 1975
William T. Watson—ASA 1927