FILE

The Actuary

The Newsletter of the Society of Actuaries

VOL. 16, NO. 9 NOVEMBER, 1982

THE NORTHEASTERN UNIVERSITY EXPERIMENT

by Geoffrey Crofts and Richard L. London

The Graduate School of Actuarial Science at Northeastern University closed its doors at the end of 1981, terminating a seventeen-year experiment in actuarial education.

It was unique in its field. Designed to assist employed actuarial students to prepare for the Society examinations and to earn a Master of Science degree on the cooperative education plan, its courses covered four of the Society's examinations beyond the preliminary level. The student's employer paid tuition and, usually, a living allowance during each school term. The student attended Northeastern for a ten-week term just before examination time, returning to actuarial employment between academic terms.

This was the brain child of the late Harold A. Garabedian who, along with Byron K. Elliott, then simultaneously Board Chairman of both the John Hancock and the Trustees of Northeastern University, obtained the support of several Boston insurance companies and launched the program in 1964. Mr. Garabedian recruited Geoffrey Crofts as Dean and Director of the school, as well as its principal instructor, and himself taught in the program for several years.

The Growth Years

Difficulty in recruiting actuarial students in the face of keen competition from such industries as engineering, computer science and aerospace, motivated employers to use sponsorship of the Northeastern degree program as a recruitment incentive during the second half of the 1960's and early 1970's. John Hancock Mutual Life, the largest employer of actuaries in the local area, con-

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ELECTIONS 1982

The results announced in Washington are:

President-Elect	Dwight K. Bartlett, III
Vice Presidents	Linda B. Emory Robert D. Shapiro
Secretary	Kenneth T. Clark
Treasurer	Robert J. Johansen
Director of Publications	Edward J. Porto
Board of Governors	Allan D. Affleck Edward H. Friend Walter L. Grace Michael B. Hutchison Burton D. Jay John O. Montgomery

The number of votes cast, from among 4,782 eligible voters was 2,580 (54%). In 1981 and 1980, these percentages were 52.0% and 56.3%.

1893 PHOTO

This issue features on its center pages a photograph of pioneer actuaries at the October 1893 meeting of the predecessor body to our present society —then only 4 years old.

A COMPETITION FOR RESEARCH GRANTS IN ACTUARIAL SCIENCE

Sponsor

This competition is sponsored by the Actuarial Education and Research Fund (AERF).

Who May Enter

You are eligible if you are either:

1. A member of the Society, the Academy, the Casualty Actuarial Society, the Canadian Institute or the Conference, these being the five actuarial bodies that support the AERF; or,

(*Continued on page 3*)

FASB'S TENTATIVE CONCLUSIONS ON PENSION ACCOUNTING

by Anthony C. Deutsch

Release is imminent of the Financial Accounting Standards Board's tentative conclusions on its project, *Employers' Accounting for Pensions and Other Postemployment Benefits.* From these will come an Exposure Draft in 1983, and then, in 1984, a final accounting standard to supersede APB Opinion No. 8 and SFAS No. 36, and to govern the content of pension information in the audited financial statements of U.S. business enterprises.

Summary of FASB Conclusions

These conclusions, involving so far only single-employer non-insured defined benefit plans, may be summarized thus:

(1) A pension liability and an intangible pension asset are to be recorded on the employer's balance sheet, measuring the liability by the unit credit actuarial cost method. For pay-related plans, projected unit credit prorated by service is required; for other types, the traditional form is retained.

The net liability will be the unfunded actuarial liability, valuing assets at market, reduced by the remaining unamortized balance of current and prior years' actuarial losses, which for this purpose includes the effects of changes in actuarial assumptions as gains or losses. FASB calls this balance the "measurement valuation allowance." (See below for the amortization process.) The intangible pension asset is to be the remaining unamortized balance of current and prior years' plan amendments.

(2) Pension expense must also be determined by the unit credit method. Periodic pension expense will be the sum

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The Actuary

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The Society is not responsible for statements made or opinions expressed herein. All contributions are subject to editing.

EDITORIAL BY THE PRESIDENT

Barbara J. Lautzenheiser

HOW THE WORLD SEES US

What's your reaction to:

Bic—the pen that didn't have the personality to be a Sheaffer.

It's a great ad for Sheaffer, isn't it? But, what's it do for Bic? Yet, how many times have you heard, or even jokingly repeated, "an actuary is a person who didn't have the personality to be an accountant." Great ad for accountants? Maybe—but I'm sure it doesn't do much for actuaries, either.

And when we say "accountant," do we think of "one who is skilled in the practice of accounting or who is in charge of public or private accounts" (Webster)? Of course not. We think of the work they do, the education and training they have, the special skills they possess. Each accountant we know has individual characteristics, individual skills and a different level of skills. It's from all these factors that we draw our perception of what is an "accountant".

Lately, there has been growing concern over defining what is an actuary, and what is the value of an FSA. In an effort to identify ourselves to the public, our companies, our legislatures, we struggle for definitions—adding, subtracting, or changing words. But no definition, no matter how accurate or succinct, is going to give us that identity. What will matter is whether we speak out on issues of concern to others. What will matter is whether when we do speak out, we do so in a professional manner, expressing our knowledge, education, expertise, perspective, and most importantly, our integrity. What will matter is whether we say—"I'm an actuary—I'm a Fellow or Associate of the Society of Actuaries". Some of us are more statistically oriented than others, some are more technically oriented, and some stronger in administration or management. Our proportions may change, but the range of our diversity won't. That's because we are individuals. Even so, we are unified in our education, in our integrity and in our profession.

We—Fellows and Associates of the Society of Actuaries—are what others see of us, hear of us, and read of us. So the next time an issue comes up that's of concern to you, talk about it, write about it, and always make clear that it's a Fellow or Associate that's talking or writing.

Shakespeare said, "that which we call a rose by any other name would smell as sweet". I say, "that which we call an actuary by any other name would be as great". In the main, actuary is defined by the way others see that actuary.

And the way they see us is up to you:

To speak,

To write,

To be visible as a Fellow or Associate of the Society of Actuaries.

LETTERS

Surviving The Exams

Sir:

May I, as a new Fellow, offer encouragement to beginning students, as well as to those thinking about giving up short of Fellowship.

I heartily recommend George R. Dinney's article, "The Actuary Revealed" (March 1979 issue). Looking back upon years of study and more "fives" than I care to remember, my reflections are mirrored and eloquently expressed in Mr. Dinney's words:

> ". . . actuarial students are inclined to protest against the heavy study requirements . . . You hear the argument advanced frequently that one's education is not enhanced by sheer memorization of vast amounts of technical data, and that this kind of study load does nothing to develop the judgmental or thinking qualities that should form the foundation of the educational process. However much I may have endorsed this argument when I was a student, I believe it to be fallacious. Of course, much of what we must learn is drudgery. But it is a delusion to believe that you will ever be free, as a student or later in your career, of the need to assimilate large amounts of information. The trick is to foster and to develop a thinking process that will enable you to process information in the most economical and efficient way. In effect, study and work are best handled when you can begin to treat them as a kind of contest or game . . .
>
> "One could argue that the business superiority of the actuary in insurance matters is the result, in part, of his trial-by-fire in preparing for actuarial exams. (Their) rigors develop the habit and the discipline that the actuary needs in fullest measure when he begins to practice his profession."

With all due regard to those of my colleagues of far greater intellectual abilities, I suggest that exam success for one possessing reasonable intelligence

(*Continued on page 8*)

Competition For Grants

(Continued from page 1)

2. A full time faculty member of a U.S. or Canadian college or university, having teaching and research responsibilities in a field related to actuarial science (mathematics, statistics, computer science, economics, demography, insurance, law, business), and holding a terminal academic degree, such as Ph.D., D.B.A. or a law degree.

Grants are not available to support dissertations or other student research projects.

Eligible Themes

In defining what constitutes actuarial science, the Awards Committee will be guided by the current educational programs of the Society and Casualty Actuarial Society. Thus, proposals in mathematics, statistics and computer science must be on topics potentially helpful in designing and managing financial security systems, not just general topics in law, economics or finance. Proposals related to insurance issues or on operational and managerial aspects of insurance companies or employee benefit plans are welcome provided the topic is of broad interest. Research may be either theoretical or empirical; projects relating to current public policy issues, or having direct applications, will be given preference.

Those considering entering this competition are invited to discuss their planned theme with the AERF Research Director.

Grant Amounts

Grants up to $10,000 are available. Funds may be used to compensate grant recipients or for computer programming and time, secretarial services and data collection activity. Money will be disbursed periodically throughout the project, and will be contingent on progress on the research.

How To Apply

Information and application forms and requirements may be obtained from: C. J. Nesbitt, Research Director, AERF, Dept. of Mathematics, University of Michigan, Ann Arbor, MI 48104.

JEWELL WINS HALMSTAD PRIZE

The third David Garrick Halmstad prize has been awarded to William S. Jewell, Sc.D. (M.I.T.), of University of California at Berkeley. The prize-winning paper was *Models in Insurance: Paradigms, Puzzles, Communications, and Revolutions*, presented to the 21st International Congress of Actuaries in June 1980, and later presented in essence to the Institute of Actuaries in London, and the Society of Actuaries in Atlanta (October 1981).

Professor Jewell's actuarial connections are as a member of the Actuarial Association of The Netherlands and the Association of Swiss Actuaries.

The history and sponsorship of this award were described in this newsletter in May 1980.

We extend hearty congratulations to Dr. Jewell, whose award is being presented at the Casualty Actuarial Society fall meeting. It is noteworthy that all four prizewinners (one prize was presented jointly) have been in the academic field, and only one of this quartet (James C. Hickman) is an F.S.A.

Awards Committee

The Awards Committee members are:

Arthur W. Anderson, A.S.A., F.C.A., M.A.A.A.
Charles A. Hachemeister, F.C.A.S., M.A.A.A.
James C. Hickman, F.S.A., A.C.A.S., M.A.A.A., Ph.D.
Robert V. Hogg, Ph.D., University of Iowa
John A. Mereu, F.S.A., F.C.I.A.

This Committee, coordinated by the AERF Research Director, will evaluate proposals and make recommendations to the AERF Board.

Time Limit

Proposals must be submitted to the AERF Research Director by February 1, 1983. Grants will be awarded by April 15, 1983.

Rights To Publish

Since the competition's goal is to advance actuarial science, the result of each project should be a manuscript suitable for publication in a scholarly journal. AERF reserves the right to publish the results of any research it has funded; if this right is not exercised, suitable credit should be given AERF at time of publication. □

THE FIRST NOTATION PROPOSAL FROM DOWN UNDER

by Frank G. Reynolds

(This is Article No. 4 in a series.)

In October 1971, a committee of the Institute of Actuaries of Australia proposed a new actuarial notation, built on the proposal of Boehm, Reichel et al, but more practical. A prime objective was that it be capable of direct incorporation into computer programmes.

A central symbol was used, with additional letters, not bars and superscripts, to identify the variables. Also, premium symbols were modified to describe the benefit, and the letters b, B, to identify limited benefit forms, e.g.,

Current	*Proposed*
μ_x	qc(x)
$\ddot{a}^{(m)}_x$	adf(x)
$A_{x:\overline{n}\rceil}$	B(x,n)
A_{XYZ}	AAA(x,y,z)
$\bar{P}_{x:\overline{n}\rceil}$	PcB(x,n)

Symbols based on the letter "Z" were introduced for summation, differencing, integration and differentiation. Interest and mortality as variables were recognized.

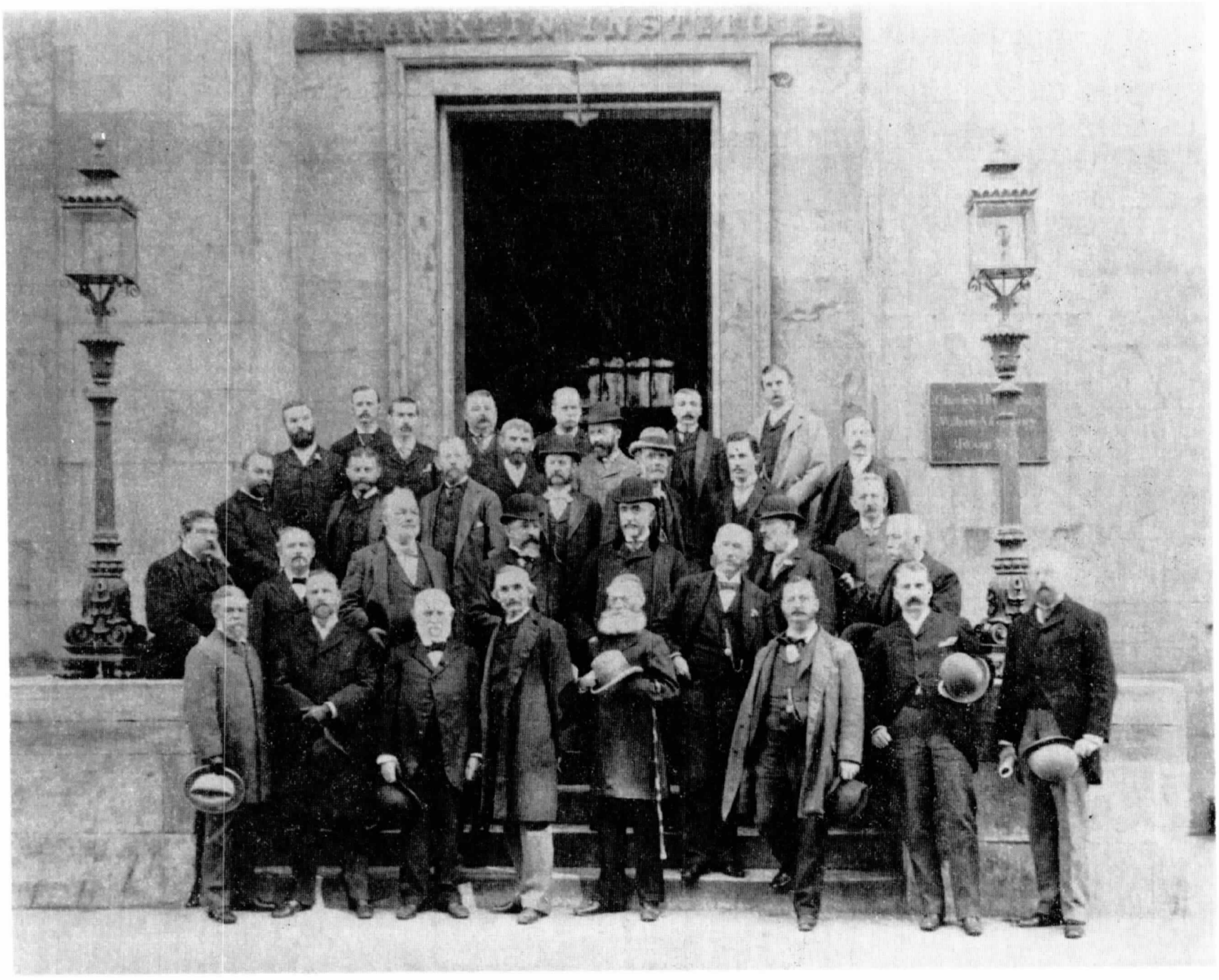
This was an attempt to produce an actuarial programming language rather than just a standard notation. But practicality was damaged by use of upper and lower case letters.

In this quantitative jump forward, the vexing difficulty with parameter strings was largely solved. But the system's incompatibility with many computers and its narrower scope than present notation condemned it in some quarters. □

Deaths

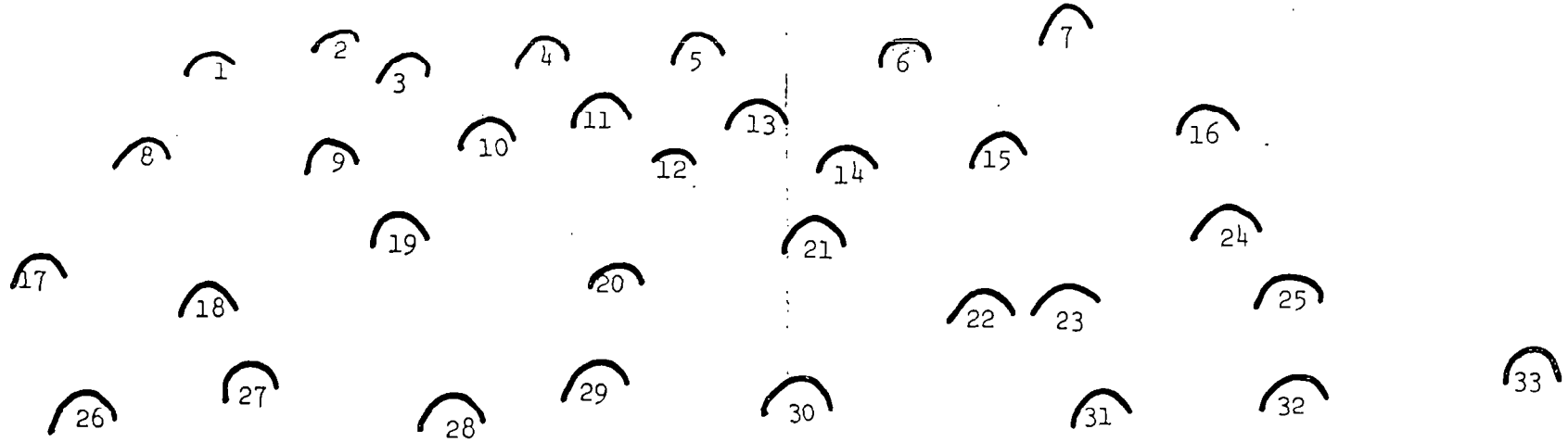
Walter S. Dewar, F.S.A. 1959
Harry F. Gundy, F.S.A. 1931
John V. Hanna, A.S.A. 1919
Leslie R. Martin, F.S.A. 1925
Stuart E. Tinker, F.S.A. 1949
Charles B. Baughman, A.S.A. 1963*

*Mr. Baughman is a former member who has long been in ill health.



ACTUARIAL SOCIETY MEMBERS PHOTOGRAPHED AT FRANKLIN INSTITUTE, PHILADELPHIA
ON THE OCCASION OF THE SOCIETY MEETING, OCTOBER 19-20, 1893.

Numbers in parentheses below correspond to the following chart.



Presidents of Actuarial Society of America (in order of term of office)

1889-91 Sheppard Homans, Provident Savings Life, New York (26)
1891-93 David P. Fackler, Consulting Actuary, New York (27)
1893-95 Howell W. St. John, Aetna (29)
1895-97 Emory McClintock, Mutual Life of N.Y. (21)
1899-'01 Thomas B. Macaulay, Sun Life of Canada (1)
1901-03 Oscar B. Ireland, Massachusetts Mutual (5)
1903-05 Israel C. Pierson, Washington Life, New York (20)
1906-08 Daniel H. Wells, Connecticut Mutual (8)
1910-12 Archibald A. Welch, Phoenix Mutual (6)
1914-16 James M. Craig, Metropolitan (18)

Other Members (in alphabetical order)

David G. Alsop, Provident Mutual (2)
Jesse J. Barker, Penn Mutual (12)
James C. Crawford, Northwestern Mutual (10)
George Ellis, Travelers (17)
Clayton C. Hall, Maryland Life, Baltimore (33)
Augustus F. Harvey, Missouri Insurance Dept. (19)
Francis H. Hemperley, United Security Life & Tr., Phila. (7)
William Hendry, Mutual Life of Canada (30)
James M. Lee, Berkshire Life (23)
Elbert P. Marshall, Union Central (11)
William A. Marshall, Home Life, N.Y. (24)
William McCabe, North American, Toronto (22)
Walter S. Nichols, U.S. Ind'l Ins., N.J. (14)
Sydney N. Ogden, Mutual Benefit Life (32)
Maximilian H. Peiler, Aetna (9)
Horace C. Richardson, New York Life (4)
Edward J. Sartelle, State Mutual (3)
Henry W. Smith, "Ins. Register", Phila. (25)
Edward L. Stabler, Manhattan Life (15)
William T. Standen, United States Life (31)
William E. Starr, State Mutual (28)
Asa S. Wing, Provident Mutual (13)
George B. Woodward, John Hancock (16)

SECOND SOFTWARE CATALOG

Popularity of the first (April 1982) Actuarial Software Catalog easily warrants a second edition, planned by the Computer Science Committee for early 1983. Any reader who has fresh information on packages available on time-sharing services, in-house computers, mini- or micro-computers, please tell Matt B. Tucker at his Yearbook location.

Northeastern Experiment

(*Continued from page* 1)

tributed significantly to the program, sending a large number of students each session, and others followed suit.

Enrollments increased steadily. Students were sponsored by employers in many areas of the United States and Canada. A second full-time faculty member, Richard L. London, was added to the staff in 1968 and a third in 1971. In 1969 the school began to offer also non-degree credit courses covering the Fellowship curriculum, and hired several part-time instructors to help teach these.

In 1976 these courses were incorporated into the degree-credit offerings, making Northeastern Graduate School of Actuarial Science the first to offer academic credit for courses covering the entire Society syllabus beyond the preliminary examinations.

Years of Decline

The economic recession of the early 1970's put pressure on employers to reduce expenses; one area of such reduction was the fairly expensive Northeastern sponsorship. More significantly the recession-bred unemployment and lessened job opportunities in other mathematics-related fields caused more qualified job seekers to look toward the actuarial field; hence, actuarial recruitment difficulties declined, and so did motivation for Northeastern sponsorship. At about that time, the John Hancock found itself actuarially over-staffed and discontinued its sponsorship.

The nearly complete discontinuance of degree-program sponsorship by the middle 1970's resulted in drastically reduced enrollments. Companies were, however, still willing to send some students to the school for an occasional term to prepare intensively for particular Society examinations. And, by the late 1970's the student body usually included as many as ten year-round students from other countries who were primarily interested in the Master's degree.

But by 1980, the adverse economic environment had reduced the single-term enrollments to the point at which the program was no longer viable. Overall, the pass rate of Northeastern University students on Society examinations had been 75%.

What Does This Tell Our Profession?

Professions such as medicine and law look to universities for a high level of extensive specialized education and research. But the actuarial profession appears to look to such institutions for recruits who are prepared in fundamental mathematics and sometimes the beginnings of actuarial education—not particularly for developing the thorough understanding of the wide spectrum of knowledge that will be expected of a professional actuary.

The question is well worth discussing —What *does* the actuarial profession expect of academic institutions?

Ed. Note: Readers' views on this large question will be welcomed for our columns. □

SOCIETY'S OPERATING RESULTS AND 1982-83 BUDGET

by Robert J. Johansen, Treasurer

Results For Year Ended July 31, 1982

Thanks to the high yield on our short term asset management account and to constant attention to budgeting in our cost centers, 1981-82 income exceeded outgo by $79,000; we had budgeted for only a $3,000 margin (see *The Actuary*, April issue). Income was $66,000 over budget, expenses were $10,000 below budget.

Budget For The Year Ahead

Seminars and Meetings are budgeted to be just self-supporting, our Education and Examination system nearly so. A moderate dues increase ($10 and $5) effective February 1983 has been found necessary because of the prospect of lower yield on invested funds and the certainty of a substantial rent increase in September 1983 when the Society's favorable 10-year lease will expire.

Society Income and Expense

(Amounts in Thousands)

	Fiscal Years Ending July 31st		
Income	1980-81	1981-82	*Budget* 1982-83
Membership Dues	$ 801M	$ 906M	$ 1,058M
Seminars	186	369	391
Meetings	264	323	390
Education & Examinations	830	951	1,032
Publications	136	77	85
Investment Income	134	190	150
Other Income	408	392	365
Total Income	$ 2,759	$ 3,208	$ 3,471
Expenses			
Seminars	208	333	390
Meetings	261	327	392
Education & Examinations	1,056	959	1,086
Public Information	46	79	79
Research Services	3	89	105
Other Member Services	873	1,002	1,035
General & Administrative	283	340	317
Total Expense	$ 2,730	$ 3,129	$ 3,404
Income less Expense	+ 29	+ 79	+ 67

FASB

(*Continued from page 1*)

of three components: normal cost, interest on the unfunded actuarial liability, and a principal "repayment" of the intangible asset and the measurement valuation allowance. Principal "repayment" which has nothing to do with whether or not a contribution is actually made, is computed as a percentage of the remaining unamortized balance at the start of the period; that percentage is calculated by dividing 100 by the average remaining service period of all active participants, which makes the denominator an average multi-decrement $\bar{e}_x$ whose value might tyically be about 20, resulting in a principal repayment percentage of 5%. By contrast, the comparable first year percentage for a 30-year level payment amortization is usually about 1% at customary assumed interest rates.

One should note that the remaining unamortized balance of the intangible asset (or the measurement valuation allowance) is just the sum of the originally established amounts reduced by subsequent principal "repayments". The FASB doesn't adjust the intangible asset by interest charges; its accounting treatment is similar to depreciation of a fixed asset.

If a plan had always followed these accounting rules, the difference between the net pension liability and the intangible asset would simply be the excess of pension expense over contributions, i.e., the familiar APB Opinion No. 8 liability using the required unit credit expense method and valuing assets at market. The full effect of plan amendments would be immediately reflected in both liability and asset items. Furthermore, the effects of gains and losses (and of changes in assumptions) are recognized only prospectively.

(3) In moving from the present to the proposed accounting method, a company must initially record its unfunded actuarial liability as its balance sheet liability but it may determine the intangible asset on either of two bases: as the net liability, or as the amount that would have been recorded if the proposed method had always been in use.

Poorly funded plans will tend to choose the former, well funded the latter, alternative.

(4) With respect to other postemployment benefits, some form of advance accrual will be required; pay-as-you-go will no longer be acceptable.

Open Issues

Several major issues remain unresolved, such as:

> Will the FASB mandate actuarial assumptions? The Board has expressed its preference for an "explicit approach" to wage increase and interest assumptions.
>
> Will FASB follow an approach for other postemployment benefits similar to that for pensions?

Issues arising from multi-employer plans, foreign plans, insured plans, defined contribution plans, and plans terminating or being curtailed, will be discussed in an "Invitation to Comment", to emerge in early 1983.

Implications

The following are just a few of the many profound questions raised by these tentative conclusions:

> What will be the effect on reported pension expense, hence on reported earnings?
>
> Will plan formation or improvement be inhibited?
>
> To what extent will employers decide to fund their plans in accordance with the mandated expense method? If they do, what will be the actuary's role?

What Can Be Done?

The Board has staked out a position which in many ways represents a radical departure from both previous GAAP accounting and traditional actuarial practice. It is imperative that pension actuaries who are concerned about the Board's decisions act now to tell their clients how they may be affected. Only if a broad cross-section of the business community expresses its views forcefully, will the Board be likely to alter its conclusions materially. □

STUDY NOTES OF GENERAL INTEREST

As in the past, several of our new Study Notes are likely to prove useful to actuaries in their daily practice. Here is a selection. Send your request, with check or money order in U.S. funds payable to Society of Actuaries, to:

Society of Actuaries
Box 98474
Chicago, IL 60693

6-120-82	Current Issues in Regulation of Financial Security Programs in the U.S., by Vincent W. Donnelly	$4.00
7EU-609-82	Multiemployer Pension Plan Amendments Act of 1980, by Lall Bachan	$4.00
9LB-408-82	The Product Development Process for Insurance Companies, by Allen D. Booth and Robert D. Shapiro	$3.00
9LB-410-82	Universal Life: A Product Analysis, by David N. Becker	$3.00
9LB-618-82	Underwriting Users of Alcohol, by Gary Corliss	$3.00
9PB-701-82	Role of the Actuary as an Expert Witness, by Donald R. Anderson and Robert M. Chandler	$3.00
9PU-809-82	Limitations on Benefits and Contributions for Tax-Qualified Defined Benefit and Defined Contribution Plans, by Vincent Amoroso	$3.00
9PU-810-82	Withdrawal Liability, by Vincent Amoroso	$3.00

L.N.C.

MAIL ALERT

You should have received the *Record*, Vol. 8, No. 2 covering the Orlando Spring Meeting. If not, tell the Society office in Chicago.

Letters

(*Continued from page 2*)

comes most from having a clear vision of the goal of FSA, and an unwavering sense of direction, singleness of purpose, and determination to attain that goal. These qualities, developed and enchanced by the examinations, qualify the actuary for his work as a problem solver, and equip him for non-traditional roles not necessarily closely related to life insurance.

Edward F. Cowman

* * * *

Humpty Dumpty

Sir:

"The question is" said Alice, "whether you can make words mean so many different things."

—Through The Looking-Glass

Pension actuaries may mean either—occasionally both—of two different things when we use the word "cost":

(1) Cost may refer to *incidence of cost*, i.e., the "pension plan contribution" (preferred by the Academy Committee on Terminology).

(2) Or, cost may mean *ultimate (or foregone)* cost, i.e., the "loss incurred to gain something" (Webster's dictionary).

The resulting confusion has been aptly illustrated (by me) in the paper "Indexing Pensions—Protecting Postretirement Purchasing Power," to appear in the *Transactions*, Vol. XXXIV, and in various discussions at our 1982 Houston meeting of that and other papers, especially Jeffrey J. Furnish's "Pension Plans In An Inflationary Environment."

In the well known equation, (used in Mr. Furnish's paper), which holds over the life of a plan,

$$C + I = B + E$$

(Pension Plan Contributions plus Investment Income = Benefits plus Expenses).

C is the pension plan contribution (1. above), C + I (or of course B + E) is the ultimate (or foregone) cost (2. above).

Although B + E does mathematically equal C + I, it doesn't make semantic sense to say that Benefits plus Expenses are "costs"; rather, costs (pension plan contributions) supplemented by investment income, the foregone or ultimate costs if you will, finance (B + E), the benefits and expenses to be disbursed from the fund. Furthermore, most actuaries differ with Mr. Furnish and define ultimate cost—or, carelessly, cost—as B + E − I.

Greater clarity will be achieved if we distinguish "cost" or pension plan contribution as a theoretical estimate for the current period, (normal cost plus amortization payment), as opposed to the actual Cost (pension plan contribution) B + E − I over the life of the plan, unknown until the plan is wound up. If our estimates are good, the sum of our theoretical pension plan contributions over the years will converge to C, the contributions actually needed for the plan.

If all actuaries will follow the preferred terminology using pension plan contribution differentiated as theoretical or actual, rather than cost ("C"), and referring to B + E as benefits plus expenses (*not* its mathematically equivalent ultimate cost often loosely called "cost", creating such confusion) . . . or will clearly define "cost" whenever they use that word, we will be speaking the same language, with great advantage to exchanges of ideas amongst ourselves as well as with the public.

Gerald Richmond

* * * *

Gain and Loss

Sir:

Now that we have had a STOPGAP movement, I say we should have a STOPGAAP movement.

All the changes going on in the life insurance environment are making a new GAAP era necessary every year. This means all new GAAP factors, a big actuarial undertaking.

Then when earnings aren't what were expected and the GAAP reserve isn't as was projected, what do you tell management? You start rationalizing by talking about changes in seasonal mix, deferred premiums, due premiums, lapses, shifts from permanent to term, etc. etc. But how many of us understand what is causing reserves to change as they do? Large clerical errors get rationalized away, to be found later.

We set up these reserves by prognosticating lapse, interest and mortality rates five, ten, twenty years from now. We can only guess how many of our re-entry term people will re-enter, and what mortality the rest will experience. We have to predict under what conditions we will change premiums on our indeterminate premium policies. Then, auditors come, seek out justifications for our guesses, and express opinions about them.

We shouldn't take out the GAAP reserve increase in determining gain from operations; instead, we should subtract actual benefits, expenses and policy dividend provision from premiums and investment income; the rest goes into liabilities, surplus and capital. We know how much statutory liabilities increase; we know our capital; we are left with a picture of our surplus changes. By seeing how they change over a year or two we can make a sensible recommendation on whether the dividend allotment is about right, or needs raising or lowering. Afterwards we can examine the effects of the environment but we won't have to resort to crystal balls.

GAAP reserving doesn't make sense any more. Let's simplify the process.

George F. Letkiewicz

* * * *

Investing During Inflation

Sir:

We in the U.K. already have CPI-linked bonds ("Hester Plan", Robert J. Johansen, June issue), as Alistair Neill has reported in your May 1982 and September 1981 issues.

Their yields at current prices are clustered around 3% per annum. Since one is seeing yields of 12-13% p.a. on comparable conventional securities, our market must expect the Retail Prices Index (our equivalent of your CPI) to increase by about 9-10% p.a. over the period to maturity, ignoring the reduced reinvestment problem.

I doubt, however, that the market yet understands these securities. When the conventional gilt-edged security falls in value through fear of inflation, the corresponding index-linked gilt should rise, but this doesn't always happen.

Our index-linked bonds weren't popular when only pension funds and insurance companies were allowed to buy them; since becoming available to all, they still seem to offer too low a return.

Yes, the Hester Plan will work, but one must define which kind of inflationary economy one is talking about.

Huw R. Wynne-Griffith