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Forecast 2000 forum generates substantial media coverage

by Robert L. Brown

The recent Forecast 2000 forum on the environment held in Toronto dealt with such issues as increased taxes and higher insurance premiums to cover costs of natural disasters. The forum generated a lot of positive worldwide media coverage and brought more focus on the actuarial profession, despite the somewhat negative tone the survey projected.

In discussing the results, based on a survey of casualty actuaries, a positive pro-active stance was emphasized with the media.

In particular, it was our contention that through insurance premiums, the business sector will see real economic incentives and rewards for being responsible corporate citizens with respect to pollution control (e.g. reduced premiums for safe, inspected storage facilities). Furthermore, we stressed that actuaries have an essential role to play in assessing the economic value of the pollution liablity risk, both in setting equitable premiums and also in assisting the courts in adjudicating penalties in cases of damage or injury.

Before the July 11 Forecast 2000 seminar, actuaries with a particular interest in the topic were polled on a series of relevant questions. In this case, the response was from 332 property/casualty actuaries (out of 1200 polled). Questions varied from the effects of a catastrophic natural disaster to concerns about environmental pollution. The results of the survey, which acted as the focal point

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Continuing education: The debate goes on and on

by Burton Jay

Should actuaries have a formal program for continuing education? This question has been asked, studied and debated at least since the early part of the decade. For many years, accountants, physicians and lawyers of many states have had continuing education requirements to retain their license to practice. Many other professions, including some groups of life insurance agents, require their members to participate in continuing education activities or in some way recognize those who do. Where are the actuaries?

The topic was on the agenda of the Society's Services to Members Policy Committee as early as 1983.

In 1984, a joint task force representing the actuarial bodies in North America was formed to consider the question. In a September 1985 report to the Council of Presidents (COP) the task force recommended that each founding organization of the Academy adopt a similar continuing education recognition program. The Conference of Actuaries in Public Practice (CAPP) was already in the process of adopting a program similar to the one envisioned by the joint task force. That program would have recognized – with an asterisk or other designations in the organization's yearbook – those individuals who fulfill the required hours of continuing education and submit documentation to the organization's administrative offices. The American Society of Pension Actuaries has also had such a program for a number of years.

Another type of program involves specified continuing education requirements to retain one's professional designation. The Joint Board for Enrolled Actuaries recently implemented a program that members must fulfill to retain their Enrolled Actuary designations. The COP deferred action

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Pricing on a GAAP basis

by Bradley M. Smith

Life insurance companies find themselves in a significantly more complicated environment than that of just a few years ago. Managements face an uncertain investment environment, the real possibility of deteriorating future mortality due to the spread of AIDS, and alternative and competing distribution systems. They also are challenged by increasing government involvement at the state and federal levels, competition for the consumers' life insurance dollars from external industries, the increasing presence of non-U.S. companies within the U.S. marketplace, as well as the specter of a consolidating industry where poor performers are absorbed by their competitors.

All these developments have contributed to innovative product offerings as well as a shortened product cycle. The product development function has likewise evolved from primarily premium determination to include product design, market identification and penetration estimation, producer compensation determination, contemplation of investment strategy, and determination of appropriate statutory and GAAP financial statement methodologies.

The introduction of a new product is a tactic used by the management of a company attempting to fulfill the objectives defined by its underlying corporate strategy. The product will be successful, and should be judged so, only to the extent that it is consistent with and enhances the company's ability to attain those objectives. The emergence of earnings (on a GAAP and statutory basis) as well as the level of earnings must be consistent with these objectives.

Typically, the pricing process, which is appropriately a subset of the product development function, has addressed the level of earnings and not the emergence of earnings of a product. Thus, the pricing process has attempted to ensure that the return on invested capital anticipated from a new product exceeds, by an appropriate margin, the cost of that capital. It has not attempted to ensure that the emergence of that return is consistent with the company's needs. The teaching session on "Pricing on a GAAP Basis" conducted at the SOA Annual Meeting in New York in October addressed forces affecting the emergence of GAAP earnings on products sold in today's insurance marketplace and how they affect the product development process.

The last thing that an actuary involved in product development wants is to explain to an unsuspecting CEO why increased sales from a new product have not resulted in the GAAP earnings growth anticipated by the CEO. The level of GAAP earnings, which determines the company's return on equity (ROE), will affect outsiders' perceptions of the company, thus affecting a publicly-traded life insurance company's stock price. This directly affects the company's ability to raise capital that may be needed to implement its long-term corporate strategy. Thus, differences in the emergence of earnings anticipated by the CEO and those occurring solely to the application of differing accounting methodologies can have disastrous ramifications for the company's plan. Yet, this occurs with increasing frequency within life insurance companies due to ever-evolving accounting standards that have resulted in an emergence of earnings on products offered today that differ substantially from the emergence of earnings using FAS No. 60 methodologies.

In short, there is a difference between the CEO's expectations and the actuality presented by these new accounting standards. It will be the actuary's responsibility to close this expectation gap. Clearly, this will be less painful before a new product is introduced than after, if initial earnings emergence proves disappointing. Most CEOs hate surprises, and a major aspect of an actuary's job is avoiding these surprises.

Thus, the following issues must be addressed by an actuary involved in the product development process.

- FAS No. 97: This pronouncement promulgates the appropriate accounting methodologies for universal life products, investment contracts (SPDAs, FPDAs, GICs, structured settlements), limited payment contracts, and policy replacement situations. It has definite implications as to desirable product design.
- FAS No. 96: Although, as of this writing, the methodologies and the final date of adoption of this standard have not been set, adoption in its current form will have major effects on the after-tax GAAP earnings emergence of various life insurance products.
- Use of company-wide projections in the product development process: To avoid surprises, company-wide projections using differing production assumptions must be used to illustrate the incremental effect of a new product on company-wide results. These projections also provide a valuable map useful in identification of reasons for deviations from expected in the actual results.
- Relationship between GAAP and statutory profitability measures: The relationship must be understood between GAAP ROE and statutory return on invested capital (ROI), as well as GAAP profit margin, the effect of required (target) surplus and pre-tax and after-tax results.
- Increased communication required: Again, to avoid surprises, the financial reporting methodologies (as well as the investment strategy, target market, underwriting guidelines, profitability objective, state submission requirements, etc.) must be understood by all those involved. Financial reporting methodologies, as well as the other elements listed above, should be determined/identified during the product development process, thus allowing for the possibile alteration of product design when needed to meet company expectations. Variables in the accounting methodologies can be used (i.e., DAC amortization period), and these should be understood and set so as to meet company objectives within the boundaries of acceptable accounting practice.

It must be remembered that new product introduction is merely a tactic to attain company objectives. Thus, success or failure of a particular product introduction should be judged on this basis.

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