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Charles McLeod
Editor responsible for this issue

Editor
Robert D. Shapiro, FSA
shapiro@netstream.net

Associate Editors
Janet M. Carstens, FSA
carstej@towers.com
Charles C. McLeod, FSA
charlesmcleod@sympatico.ca
Jay A. Novik, FSA
jay_novik@swissre.com
Godfrey Perrott, FSA
godfrey.perrott@milliman.com
Anna M. Rappaport, FSA
anna.rappaport@us.wmmercer.com

Assistant Editors
Morris W. Chambers, FSA
mo.chambers@londonlife.com
Craig S. Kalman, ASA
craig@kalman.net
Prakash A. Shimpi, FSA
prakash_shimpi@swissre.com
Carl A. Westman, FSA
cw@actuaryoncall.com

Puzzle Editors
Louise Thiessen, FSA
thiessen@v-wave.com
Stephen Kinsky, FSA
skinsky236@juno.com
Gregory Dreher
gregory_dreher@phl.com>

Society Staff Contacts
847/706-3500
Jacqueline Bitowt, Public Relations Manager
jbitowt@soa.org
Kelly Mayo
Marketing and Public Relations Coordinator
kmayo@soa.org
Linda M. Delgadillo, CAE
Managing Director,
Marketing & Membership Services
ldelgadillo@soa.org

The Actuary **welcomes articles and letters. Send correspondence to:**
The Actuary
Society of Actuaries
475 North Martingale Road, Suite 800
Schaumburg, IL 60173-2226
Web site: *www.soa.org*

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A. Norman Crowder, III, FSA, President
Robert M. Beuerlein, FSA, Director of Publications

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EDITORIAL

Canadian actuaries at a crossroads

by Charles McLeod

This issue contains an article on demutualization in Canada — probably the most important development in the Canadian life insurance business in 1999. By the time this issue appears, all of the five largest Canadian mutual companies will have converted, or will be in advanced stages of converting, to stock companies.

This is only part of an eventful decade in Canada — much of which has presented unusually interesting work for life company actuaries. The past 10 years have seen about half of the 20 largest companies of 1990 disappear through merger, acquisition, sale of Canadian operations (many large U.S. companies have largely or totally withdrawn from Canada), or insolvency. The number of life companies is expected to decrease further, although ownership restrictions on ex-mutual companies mean that all will continue as separate entities for at least two years.

Contrary to common predictions 10 years ago, the Canadian banks do not have a major presence in life insurance (although they do in the personal pension market). Although four of the five largest banks either bought or launched life insurance operations, none has made major inroads. This is at least partly due to restrictions on how they may approach their existing customers.

After many years of debate, the early 1990s saw the introduction of Canadian GAAP (together with the use of the policy premium method for valuing life company reserves) and a new federal insurance act. The act strengthened the role of the actuary in many ways. For example, it requires an annual report to a company's directors on the current and expected future financial strength of the company.

Yet, overall, the role of the actuary may have decreased. Twenty years ago, many life companies did not have a chief financial officer; the duties were effectively performed by the chief actuary. Now, the CFO is usually not an actuary, and the appointed actuary may be subordinate to the CFO.

Although this is partly a result of the increased complexity of today's life insurance companies and the broadened scope of their operations, could it be that our profession has become too technical? Does the volume of instructions (many promulgated by actuaries, not regulatory bodies) that an appointed actuary is required to master and follow, and the analytical work he or she must perform or supervise, mean the actuary no longer has time to observe and provide input to the broader company issues?

The increased volume of actuarial requirements is evident in other ways. Ten years ago, if a company did business in Canada, the United States, and the United Kingdom, the same actuary might certify reserves on three different bases. Today, it is common practice for the Canadian appointed actuary to certify only the Canadian reserves; NAIC reserves, for example, often will be certified by a U.S.-based actuary. No longer can one individual keep on top of the valuation requirements in multiple (or even two!) jurisdictions.

What are the opportunities for Canadian life actuaries in the next

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Demutualization in Canada (continued from page 3)

ineligible non-par policies which do not share in demutualization proceeds, or par businesses for some blocks or across entire countries may have generated a cumulative loss (a negative contribution to surplus). The Canadian allocation formulas, while indirectly linked to profitability analysis, tend to be based on factors applied to more easily identifiable proxies or "policy metrics" such as duration, premiums, cash values, or face amounts.

The status of non-par policies is also different. In almost every U.S. state, non-par policyholders vote for directors of mutual companies. Therefore, non-par policyholders have traditionally received the fixed consideration. In Canada, in contrast, non-par policyholders usually do not have the vote. The current governing statute, the Insurance Companies Act, empowers mutual insurance companies to grant voting rights to non-par policyholders, but only one company has done so. So the various Canadian demutualization plans, with the exception of Clarica (and Industrial-Alliance, a provincially registered company not subject to the Insurance Companies Act) do not provide for any demutualization proceeds to non-par policyholders.

Canada's Insurance Companies Act requires mutual companies to maintain participating and non-participating business in separate accounts. At demutualization, a restructuring of accounts takes place. The non-participating account is redesigned as the shareholders' account. The participating accounts are separated into three categories: closed block, ancillary block, and open block.

Policyholders' reasonable expectations of dividends and other non-guaranteed benefits are protected through the requirement to establish a closed block from which transfers to the shareholders account are not allowed. The assets backing the closed-block accounts established for business issued before demutualization may be commingled with the assets supporting new participating business.

The margins for adverse deviations are held in a separate participating account called the ancillary block. Shareholders are entitled to the release of these provisions as determined by the company's Appointed Actuary.

If new participating business is to be issued, sufficient shareholder capital must be placed in the open block to support five years' of new business, capital that may be repaid to shareholders when it is no longer required. Shareholders will also be entitled to a portion of the profits that emerge from the open-block accounts established for new participating business issued after demutualization.

The balance in the participating accounts after providing for the closed, ancillary, and open blocks is transferred to the shareholders' account. As shareholders, existing participating policyholders remain owners of this surplus.

At present, Canadian regulations require that large insurers be widely held upon conversion and for two years thereafter, meaning that no one person may hold more than 10% of any class of shares of the demutualized company or an upstream holding company. The minister of finance has also announced that mergers among or acquisitions of demutualized firms would not be permitted during the two-year transition period. The ownership issue is currently under review for both banks and insurance companies.

More changes ahead

So, what's next? Significant changes and opportunities are arising in the financial services marketplace as competition, consolidation, globalization, and technology continue to transform the environment. Demutualization is not the end of the story, it is merely the beginning.

Mike Lombardi, consultant, Tillinghast-Towers Perrin, Toronto, writes and speaks frequently on demutualization. His e-mail address is *lombarm@tillinghast.com.*

Canadian actuaries at a crossroads

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10 years? The pricing and reserving of segregated fund (variable annuity) guarantees need more work before all parties can have the same confidence as with traditional products. Life companies' financial problems in the past decade largely stemmed from asset quality. Actuaries can prevent the next decade's problems from being due to pricing and reserving issues — which, if they occur, will be blamed on our profession for letting them happen.

To end on a positive note: As editor of this issue, I have the role of welcoming new Society President Norm Crowder on behalf of *The Actuary's* editorial board. This issue contains his speech from the recent 50th Anniversary Annual Meeting. We wish him a successful and enjoyable year.

With this issue, The Actuary *welcomes Charles McLeod as a new associate editor. He has served on a number of SOA and Canadian Institute of Actuaries (CIA) committees, and he has been a member of the CIA Council, the Institute's governing body. Until recently, he was chief financial officer of Canada Life's U.K. division. He now runs his own life insurance consulting practice. He can be reached by e-mail at* charlesmcleod@sympatico.ca.