THE FINANCIAL REPORTER

NEWSLETTER OF THE LIFE INSURANCE COMPANY FINANCIAL REPORTING SECTION

NUMBER 43 SEPTEMBER 2000

Editor's Notes

by Thomas Nace

Codification of life insurance accounting principles has generated much more discussion in recent months than ever before as its effective date of January 1, 2001 draws nearer.

For example, there have been two releases by the NAIC of the by-now famous green and purple books, entitled *Accounting Practices and Procedures Manual*. Intimidating by their sheer size, companies are starting to crack the covers of these manuals to see what's in store for them in the following year.

In other circles, firms (my company, in particular) have put together a series of seminars focused on the actuarial implications of the pending requirements. Again, based on the attendance at the seminars and the extent of questions posed, it is apparent that interest is peaking as clients ponder the effect that codification will have on their financial reporting.

Not coincidentally, I have lined up an outstanding article in this issue of the *Financial Reporter* dealing with codification.

The article was written by Stan Cole and focuses on the life insurance aspects of codification. Stan provides a brief background as to the issues leading up to codification requirements and then provides a very good summary of many of the key Statements of Statutory Accounting Principles (SSAPs).

(continued on page 2, column 1)

Highlights of Codification Requirements for Life Companies

by Stanton L. Cole

The adoption of codification by the NAIC at its March 1998 meeting was the culmination of several years of dedicated, hard work by insurance regulators and industry representatives alike. The work product today is encompassed in two volumes published by the NAIC and entitled *Accounting Practices and Procedures Manual, version effective January 1, 2001 (As of March 2000)*. These documents incorporate the Preamble, over 70 Statements of Statutory Accounting Principles (SSAPs), 22 appendices that are based on relevant NAIC model laws and regulations, interpretations of the NAIC's Emerging Accounting Issues Working Group on GAAP guidance issued since January 1, 1997, and all GAAP cross-references to the SSAPs. The manual will be modified as necessary on an annual basis as a consequence of a codification maintenance structure that has been established by the NAIC.

Purpose of Codification

As described in paragraph 12 of the Preamble:

> The purpose of the codification of statutory accounting principles is to produce a comprehensive guide to Statutory Accounting Principles (SAP) for use by insurance departments, insurers, and auditors. Statutory accounting principles, as they existed prior to codification did not always provide a consistent and comprehensive basis of accounting and reporting. The prescribed or permitted statutory accounting model resulted in practices that could have varied from state to state. Insurance companies were sometimes uncertain about what rules to follow and regulators were sometimes unfamiliar with the accounting rules followed by insurers in other states. As a result, insurers' financial statements were not

(continued on page 4, column 1)

In this Issue

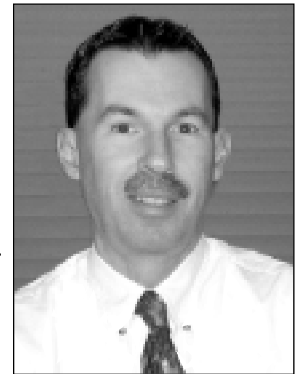
Editor's Notes
by Thomas Nace 1
Highlights of Codification Requirements for Life Companies
by Stanton L. Cole. 1
COLIFR Corner
by Kevin E. Palmer. 3
Estimating the Impact of Realized Gains and Losses on DAC Amortization for Universal Life-Type Business
by Richard H. Browne. 8
Request for Proposal (RFP) — Financial Reporting Section Council 15
Chair's Corner
by Mike McLaughlin. 16
Academy Seminar on Life and Health Qualifications Taking Shape
by Larry M. Gorski. 17
Annual Meeting Preview
by Thomas Nace 18
Dynamic Capital Adequacy Testing: Lessons from the Canadian Experience
by Mike Lombardi 20
Record Sessions for Financial Reporting Track Posted on the Web since the June *FR* 23
Letter to the Editor 24
Reinsurance and the Bottom Line
by Barry L. Shemin 26
GAAP Textbook to be Unveiled at Annual Meeting
by Shirley Shao 26

Editor's Notes
continued from page 1

Other topics represented in this newsletter deal with dynamic capital adequacy testing (DCAT) and the effect of realized gains on deferred acquisition costs (DAC). Mike Lombardi provides an overview of his Canadian experience with DCAT in his article, while Richard Browne provides insights to the mechanics of DAC amortization and capital gains in the latter article.

Updates from the Academy's Committee on Life Insurance Financial Reporting (COLIFR) meetings are quite informative and are provided in this issue by Kevin Palmer. In addition, Mike McLaughlin provides his viewpoints as Section chair in his quarterly article.

On a different front, a topic that is very current is the latest education requirements for FSAs. As such, Larry Gorski has authored an article dealing with the qualification standards for new Fellows. A session on this topic is also scheduled for the Annual Meeting in Chicago, which is previewed in this issue.


Tom Nace, Editor

Finally, two forms are included with this issue of the newsletter.

The Financial Reporting Section Council is interested in promoting research. A Request for Proposal form, included on page 15, can be cut out or copied for use in communicating potential projects to the Council that might require Section funding.

In addition, a form is provided for ordering your copy of the new GAAP textbook. Also see Shirley Shao's article on the unveiling of the new textbook.

Hope everyone had a happy and healthy summer!

Tom Nace, FSA, MAA, is vice president with PolySystems Inc., Pennsauken, N.J. He can be reached at tnace@polysystems.com.

THE FINANCIAL REPORTER

Issue Number 43 September 2000

Published quarterly by the Life Insurance Company Financial Reporting Section
of the Society of Actuaries
475 N. Martingale Road, Suite 800
Schaumburg, IL 60173
Phone: 847-706-3500 Fax: 847-706-3599
World Wide Web: *http://www.soa.org*

This newsletter is free to Section members. A subscription is $15.00 for nonmembers. Current-year issues are available from the Communications Department. Back issues of Section newsletters have been placed in the Society library and are on the SOA Web Site. Photocopies of back issues may be requested for a nominal fee.

Chairperson
S. Michael McLaughlin, ASA
Vice-Chairperson
Michael V. Eckman, FSA
Treasurer
Larry M. Gorski, FSA
Secretary
Mike Lombardi

Editor of *Financial Reporter*
Thomas Nace, FSA
PolySystems, Inc.
6981 North Park Drive, West Bldg. - Suite #303
Pennsauken, NJ 08109
Phone: (856) 663-8711
Fax: (856) 663-8712
E-mail: *tnace@polysystems.com*

Council Members:
John F. Bevacqua, FSA
James P. Greaton, FSA
Stephen J. Preston, FSA
David Y. Rogers, FSA
Barry L. Shemin, FSA

Staff Liaison, Lois Chinnock
Phone: (847) 706-3524
Email: *lchinnock@soa.org*

DTP Coordinator, Joe Adduci
Phone: (847) 706-3548
Fax: (847) 272-8548
Email: *jadduci@soa.org*

Expressions of opinion stated herein are, unless expressly stated to the contrary, not the opinion or position of the Society of Actuaries, its Sections, its Committees, or the employers of the authors. The Society assumes no responsibility for statements made or opinions expressed in the articles, or criticisms, and discussions contained in this publication.

Copyright © 2000 Society of Actuaries. All rights reserved.
Printed in the United States of America.

COLIFR CORNER

by Kevin E. Palmer

COLIFR is the American Academy of Actuaries' Committee on Life Insurance Financial Reporting. COLIFR monitors activities related to life insurance and annuity financial reporting and is actively involved in many of these activities. The committee conducts analysis and makes recommendations regarding the actuarial aspects of financial reporting issues. COLIFR met on March 22, 2000, in Chicago and on May 16, 2000, in Newark. Meetings are scheduled on September 21, 2000, in Washington, D.C. and on December 8, 2000, in Orlando. This is an update on current COLIFR activities.

Accounting for Demutualizations

On April 3, the AICPA released for exposure a proposed SOP, Accounting By Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Contracts. Comments were requested by June 5.

COLIFR's Demutualization Working Group, led by Tom Burke and Ken LaSorella, reviewed the document and prepared comments. Comments from actuaries from outside of the committee have been received and considered.

Under the proposed SOP, participating policies would generally be accounted for according to the provisions of SOP 95-1, except the insurance enterprise would need to recognize an obligation for future policyholder dividends based on accumulated undistributed earnings. In accounting for the closed block, an actuarial calculation would be required to project the emergence of earnings, called a "glide path." As actual experience emerged on the closed block, accumulated earnings in excess of those on the glide path would be credited to the policyholder dividend obligation (PDO) and not reported as stockholder earnings or equity. The COLIFR comment letter offers guidance on a number of practical issues that would need to be dealt with in establishing and maintaining the PDO.

Accounting for DAC on Internal Replacements

In June of 1999, the AICPA issued the Discussion Paper, *Accounting by Life Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Covered by FASB Statement No. 97*. The paper asked if additional accounting guidance is needed in this area, as well as what shape that guidance might take. A majority of those commenting on the paper, including COLIFR, said additional accounting guidance is needed. As a result, a task force has been formed. John Morris is representing COLIFR on this task force.

The task force started by gathering information to describe specific internal replacement situations. For a specific situation, they were asking:

- What products were involved?
- Was it a company-sponsored replacement initiative? If so, was it targeted at specific customers or contracts? How was the initiative communicated to agents or customers?
- Were underwriting concessions or compensation adjustments made?
- What quantitative measures were used to analyze the initiative?
- How did the company decide to account for the initiative?

The task force is next scheduled to meet in June.

GAAP Practice Note

COLIFR sent a GAAP Practice Survey to chief actuaries in December, and received over 150 responses. The results of this survey will be compiled, and used in preparing a GAAP practice note. Jay Zellner is leading this COLIFR effort.

Regulation XXX

The COLIFR Regulation XXX Working Group submitted a comment letter on the proposed ASOP "Compliance with the NAIC Valuation of Life Insurance Policies Model Regulation." Additionally, Steve Moorhead is leading the effort to write a practice note on applying this regulation. The intent is to have a "near final" draft at the Valuation Actuary Symposium in September.

Fair Value Accounting

The FASB published *Preliminary Views on Major Issues Related to Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value* in December 1999. The IASC published an Issues Paper on Insurance in November 1999. The Academy formed the Fair Value Task Force, led by Burt Jay, to respond to these documents. COLIFR helped to peer review letters drafted by the Fair Value Task Force. Comments on both documents were requested by May 31. The Academy's letter to the IASC was restricted to fair value issues and was delayed until early June, to be consistent with the release of the International Actuarial Association's comment letter.

Joint COLIFR/COPLFR/ Health Meeting

On May 17, 2000, COLIFR members participated in a joint meeting with representatives of the Academy's Committee on Property and Liability Financial Reporting (COPLFR) and representatives of the Academy's Health Practice Council. Much of this session was spent discussing the Academy comment letters to the FASB and to the IASC on fair value accounting. The FASB/IASC accounting documents would apply very broadly, and the Academy felt it was important to respond in a unified actuarial voice.

More generally, this joint meeting was a worthwhile opportunity to share information among practice areas. While product specifics may vary, it was interesting to see the commonality in issues being dealt with in each committee and to think about how techniques applied in one area might have useful application in another. It is expected the three committees will meet together regularly on an annual basis.

COLIFR will continue to follow these and other topics involving financial reporting. Actuaries aware of new or emerging issues are encouraged to bring them to the attention of the committee chairman, Dan Kunesh. Progress will be reported in future issues of *The Financial Reporter.*

***Kevin E. Palmer, FSA, MAAA, is vice president, Actuarial Department in Minneapolis, MN. He can be reached at* kevin.e.palmer@aexp.com.**

Highlights of Codification Requirements for Life Companies
continued from page 1

always prepared on a comparable basis.

Despite the foregoing statement, which clearly represents a thrust in the direction of national statutory accounting uniformity, the reader should be cognizant of the "states' rights" aspect of insurance regulation that remains robust even in the wake of codification. This is evidenced by the language of paragraph 19 of the Preamble:

> Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state's statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state's insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states.

Statement of Concepts

A fundamental Statement of Concepts on which statutory financial accounting and reporting standards are based provides the framework of codification. These concepts serve to constitute the accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations. The Preamble identifies conservatism, consistency, and recognition as the three fundamental concepts upon which SAP is based. Conservatism provides a margin of protection for policyholders. Consistency provides for meaningful, comparable financial information to determine an insurer's financial condition. Recognition provides for the ability to meet policyholder obligations and is predicated on the existence of readily marketable assets when both current and future obligations become due. The Statement of Concepts also indicates that SAP will use the framework established by GAAP and integrate that framework with objectives exclusive to SAP.

Disclosures

Many of the SSAPs require significantly expanded disclosures in the notes to the financial statements. Many of the disclosures are GAAP-type disclosures that have previously been required to be included in the audited financial statements of companies. Additional disclosures, however, will now be required in the annual statement filing. In all, there will be 27 Notes with multiple parts in the blank and another 13 Notes with multiple parts in the audit report. Of major significance — and new to the Annual Statement — is Appendix A-001 (Investments of Reporting Entities), which will require responses to as many as 15 separate interrogatories focused on determining the nature and types of risks a company is exposed to (e.g., foreign investments, equities, potential lack of diversification, derivatives). In addition, Appendix A-205 will require the disclosure of differences (via a reconciliation) between state basis and codification basis results, for both statutory surplus and net income. Further, this appendix requires any specific differences between state prescribed or permitted practices and codification to be disclosed.

"These concepts serve to constitute the accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations."

Foundation SSAPs

SSAP No. 1 – *Disclosure of Accounting Policies, Risks and Uncertainties, and Other Disclosures*
This SSAP requires disclosure of the difference between the insurers' accounting policies and codification (see Appendix A-205), as well as a supplemental investment disclosure schedule and related investment risk interrogatories (see Appendix A-001).

SSAP No. 3 – *Accounting Changes and Correction of Errors*
Changes in accounting principles and corrections of errors are to be reported as adjustments to unassigned funds (surplus), while changes in accounting estimates are included in the statement of income.

SSAP No. 4 – *Assets and Nonadmitted Assets*
An asset is considered to be nonadmitted if it is (a) specifically identified as a nonadmitted asset, or (b) not specifically identified as an admitted asset. This definition means that users will need to stay alert to assure that new types of assets are addressed during the maintenance phase of codification.

SSAP No. 5 – *Liabilities, Contingencies and Impairment of Assets*
This SSAP generally adopts the concept for accrual of losses and disclosure of loss contingencies that is consistent with GAAP, but with one potentially significant exception when the estimate of a loss is a range. FASB Interpretation No. 14 states:

> When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.

SSAP No. 5 provides the following: When, in management's opinion, no amount within management's estimate of the range is a better estimate than any other amount, however, the **midpoint** (mean) of management's estimate in the range shall be accrued. For purposes of this paragraph, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be used.

The use of the midpoint in a range will be applicable only in the rare instance where there is a continuous range of possible values, and no amount within that range is any more probable than any other. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine their best estimate of the liability.

This difference between GAAP and statutory practice has the potential to require the recognition of significant additional loss accruals in instances where management is unable to establish a "best" estimate. In preparation for adoption of codification, it will be critical that management analyze outstanding loss contingencies with a view toward developing supportable "best" estimates, rather than ranges of estimates, where practical.

SSAP No. 9 – *Subsequent Events*
This statement provides guidance that is consistent with both current statutory practice and with GAAP. Generally, events that provide additional evidence with respect to conditions that existed at the balance sheet date (type I subsequent events) must be considered in the determination of the amounts recorded in the financial statements; whereas, events that relate to conditions that did not exist at the balance sheet date (type II subsequent events) will not impact the amounts recorded in the financial statements. Material type II subsequent events are required to be disclosed in the notes to the financial statements.

SSAP No. 25 – *Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*
Current statutory guidance is expanded to include all related party transactions, rather than just those with affiliates. A new requirement provides for eliminating increases at the parent company level that result from transactions between downstream affiliates (unless betterment to the parent can be demonstrated). Related parties are defined as entities that have common interests as a result of ownership, control, or affiliation. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the insurance company.

SSAP No. 64 – *Offsetting and Netting of Asset and Liabilities*
Assets and liabilities shall generally be offset and reported net only when a valid right of setoff exists, except where prohibited by specific SSAP guidance (e.g., SSAP No. 62 – *Property and Casualty Reinsurance*). On the other hand, such netting when no valid right of setoff exists is allowed only when provided by specific SSAP guidance (e.g., SSAP No. 40 – *Real Estate Investments*).

Other Significant SSAPs

SSAP No. 6 – *Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers*
The due date for all premium balances is based on the effective date of the underlying contract and not on the agent/reporting entity contractual relationship. This impacts the nonadmitted asset calculation.

SSAP No. 8 – *Pensions*
The current alternative to expense pensions based on contributions is eliminated and replaced by a FAS No. 87-type accrual, modified to include only vested benefits and to nonadmit prepaid pension assets.

SSAP No. 10 – *Income Taxes*
This statement produces one of the major changes of codification in that deferred income tax assets are now an admitted asset (with limits). A FAS 109-type approach to deferred income taxes with limits is adopted. The statement applies to federal and foreign income taxes, but not state.

SSAP No. 16 – *Electronic Data Processing Equipment and Software*
These assets are limited to 3% of capital and surplus as required to be shown on the most recently filed statement, adjusted to exclude any EDP equipment and operating system software, net deferred tax assets and net positive goodwill. Depreciation shall not exceed three years.

SSAP No. 18 – *Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
Wash sales are permitted, but disclosure regarding their impact is required.

SSAP No. 23 – *Foreign Currency Transactions and Translations*
This statement modifies current SAP by requiring individual asset and liability accounts to be translated, rather than a single net adjustment. In addition, life companies will now be required to record the effect through unrealized gains and losses.

SSAP No. 26 – *Bonds, excluding Loan-backed and Structured Securities*
An impairment test is added that requires prepayment penalties and acceleration fees to be recorded as investment income.

SSAP No. 27 – *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments*
Current guidance on disclosures about financial instruments and concentrations of credit risk are expanded.

(continued on page 6, column 1)

Highlights of Codification Requirements for Life Companies

continued from page 5

SSAP No. 30 – *Investments in Common Stock*

SSAP No. 32 – *Investments in Preferred Stock*
An impairment test that is not contained in current guidance has been added. Where it is determined that a decline in fair value is other than temporary, the stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. Certain common stock transactions (e.g., stock subscriptions) are not to be recorded until settlement date, while specific guidelines for payment-in-kind (PIK) preferred stock are provided.

SSAP No. 31 – *Derivative Instruments*
This statement clarifies that mark to market accounting (i.e., recognition of unrealized gains and losses currently in earnings) shall be applied except for those derivative transactions that meet specified criteria to qualify for hedge accounting. To qualify for hedge accounting, the derivative must be designated as a hedge of a specific asset, liability, or anticipated transaction and is required to reduce the insurer's exposure to risk as demonstrated by specific criteria (i.e., high correlation).

SSAP No. 33 – *Securitization*
Current SAP is adopted, except that the gain on sale shall be recorded as realized rather than deferred and amortized over the life of the retained interests.

SSAP No. 35 – *Guaranty Fund and Other Assessments*
This SSAP engendered much protest from the P&C industry, inasmuch as it requires the accrual of assessments when an insolvency occurs. The conclusions will generally increase the accruals for many companies, especially property/casualty insurers. The provisions for prospective assessments are more conservative than the current AICPA Statement of Position.

SSAP No. 37 – *Mortgage Loans*
Impairments shall be measured based on fair value (as determined by acceptable appraisal methodologies) of the collateral less estimated costs to obtain and sell. Temporary impairments are recognized by creating a valuation allowance with a corresponding charge to unrealized loss. Subsequent to the initial measurement of a temporary impairment, if there is a significant change in the net value of the collateral, the valuation allowance is increased or decreased. Write-downs for other than temporary impairments are included in realized losses and a new cost basis established; subsequent recoveries in value are not recognized.

SSAP No. 40 – *Real Estate Investments*
Criteria are established for determining when real estate write-downs are required.

SSAP No. 46 – *Investments in Subsidiary, Controlled and Affiliated Entities*
Investments in SCAs are recorded using either the statutory equity or market valuation method. Under the statutory equity method, SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the insurer or its affiliates are recorded based on the underlying equity of the SCA's financial statements adjusted to a statutory basis of accounting and adjusted for unamortized goodwill. Insurance SCAs are recorded on the basis of the underlying statutory equity, while remaining SCAs are recorded based on audited GAAP equity. This SSAP requires that undistributed earnings and losses of the SCA be recorded as unrealized gains or losses.

SSAP No. 48 – *Investments in Joint Ventures, Partnerships and Limited Liability Companies*
Use of the statutory equity method from SSAP No. 46 is required for these entities, except limited partnerships with less than 10% ownership, which are recorded based on audited GAAP equity. This SSAP requires that undistributed earnings and losses of the investee be recorded as unrealized gains or losses.

SSAP No. 50 – *Classifications and Definitions of Insurance Contracts in Force*
Insurance contracts are classified as one of four types: life, property and casualty, deposit-type or accident and health.

SSAP No. 51 – *Life Contracts*
The current life insurance accounting model is generally maintained, except that the liability for cost of collection in excess of loading is eliminated.

SSAP No. 52 – *Deposit-Type Contracts*
Considerations received as payments for contracts that do not incorporate any mortality or morbidity risk whatsoever shall not be reported as revenues but shall be recorded directly to an appropriate policy reserve account.

SSAP No. 55 – *Unpaid Claims, Losses, and Loss Adjustment Expenses*
The concepts of SSAP No. 5 regarding range of estimates are incorporated and the definitions for ALAE and ULAE are adopted.

SSAP No. 56 – *Separate Accounts*
This statement generally requires that assets be recorded at market, except that assets supporting certain guaranteed benefits shall be reported as if the assets were held in the general account. In addition, the statement provides grandfathering rules for contracts or policy forms approved prior to codification until the provisions are in any way changed, requiring a new filing.

SSAP No. 60 – *Financial Guaranty Insurance*
The current guidance of the Financial Guaranty Insurance Model Act is rejected. Instead, the guidance is generally consistent with New York statutes with modification to require an IBNR reserve in certain situations and a

premium deficiency reserve in certain instances.

SSAP No. 63 – ***Underwriting Pools and Associations Including Intercompany Pools***
Participants in pools and associations will be required to accrue their participation and record them on a "gross" basis. Cash basis methods are not acceptable.

SSAP No. 65 – ***Property and Casualty Contracts***
Excess statutory reserves (i.e., Schedule P penalties) are eliminated. This SSAP requires recognition of an Unearned Premium Reserve (UPR) for claims made policies with defined extended reporting and an unpaid loss reserve for claims made policies with undefined extended reporting periods. The statement requires recording as a reduction of paid losses all amounts that represent contractual reimbursements to the insurer.

SSAP No. 66 – ***Retrospectively Rated Insurance Contracts***
This statement requires property and casualty insurers to record accrued retrospective premium credits as an aggregate write-in for other liabilities. It also requires that any impairment of recorded additional retrospective premiums be charged against operations, and further expands disclosure requirements.

SSAP No. 72 – ***Surplus and Quasi-reorganizations***
Disclosure of the reasons for changes in the balance of special surplus funds and the components of unassigned funds is expanded.

Survey Results

When codification was being developed in earnest back in the 1995-97 period, the industry commissioned two surveys of insurance company financials for the purpose of determining the impact that the guidance would likely have on the industry's capital and surplus (C&S). The second survey, limited to what were considered to be those Issues Papers (the antecedents of SSAPs) that would have the most impact on the industry's bottom line, and using a sampling of companies of all sizes, determined that (based on year-end 1995 financials) the industry's C&S would have decreased by $19.6 billion ($11 billion for P&C and $8.6 billion for life).

These figures, however, did not take into account the effect of the new income tax rules, primarily because that Issue Paper's guidance was not clearly understood by readers at that time and, accordingly, a variety of interpretations were applied by survey respondents in the determination of admitted deferred tax assets.

Nevertheless, despite the concerns about its limited credibility, the survey's authors estimated, based upon the survey information that was submitted on the income tax questions, that the impact on C&S at year-end 1995 would have been essentially surplus neutral for the industry. Readers are advised, however, to digest these adjustment results with at least a modest amount of skepticism, since (1) they were clearly derived by using ballpark estimates, (2) they are based on financials from 1995, and (3) a number of SSAPs were subsequently changed — although generally not significantly so — before codification was ultimately adopted by the NAIC.

Where Do We Go From Here?

The American Council of Life Insurers (ACLI), as well as several prominent property and casualty trade associations, are fully supportive of the version of codification that was ultimately adopted by the NAIC. (It should be noted, however, that there was an abundance of lobbying by the trades during the long gestation period of the project.) The industry believes that the development of uniform accounting standards is a positive step that will be beneficial to regulators, consumers, and the industry alike by providing a vehicle for the comparability of financial reporting from one jurisdiction to another, regardless of where an insurer is domiciled.

The trade associations have been and continue to be occupied with lobbying the 50 states, encouraging them to adopt codification on a timely basis, i.e., effective January 1, 2001, and with as few variations as possible. In some cases, state laws need to be modified and in others, state regulations. There may even be a few states where no action is necessary. Because of the "states' rights" aspect of insurance regulation, most jurisdictions will make at least minor modifications to the manual. At this writing, I am pleased to report that all jurisdictions appear on track to adopt codification — with or without modifications — with an effective date of January 1, 2001. (Those readers who are employees of ACLI member companies may ascertain the current adoption status by accessing the ACLI Web Site at *http://www.acli.com*).

"The industry believes that the development of uniform accounting standards is a positive step that will be beneficial to regulators, consumers, and the industry alike by providing a vehicle for the comparability of financial reporting from one jurisdiction to another...."

Stanton L. Cole, FSA, MAAA, is an actuary at the American Council of Life Insurers. He can be reached at **StantonCole@acli.com.**

Estimating the Impact of Realized Gains and Losses on DAC Amortization for Universal Life-Type Business

by Richard H. Browne

According to Statement of Financial Accounting Standards No. 97, (FAS 97), capitalized acquisition costs on universal life-type contracts are to be amortized at a constant rate based on the present value of the estimated gross profits (EGP) to be realized over the life of the book of business. Furthermore, Practice Bulletin 8 of the Insurance Companies Committee of the AICPA clarifies that expected gains and losses from sales of investments are to be included in the EGPs, and that "if the timing and amount of realized gains and losses from the sales of investments change from those expected and materially affect the expected total yield and the estimated gross profits, DAC (deferred acquisition costs) amortization should be reevaluated." Therefore it is important that when a company is considering taking significant capital gains and losses, it be able to determine the impact on DAC amortization.

It is also required that a similar exercise be undertaken when there are unrealized gains or losses on assets available for sale which are allocated to a universal life-type line of business. Under FAS 115 such assets must be marked to market with the gains or losses reflected "below the line" in surplus. It is further clarified by the SEC (Appendix D, Topic D-41 of the EITF Abstracts) that "certain asset amounts that are amortized using the gross-profits method, such as deferred acquisition costs accounted for under FASB Statement No. 97, should be adjusted to reflect the effects that would have been recognized had the unrealized holding gains and losses actually been realized." These asset adjustments are sometimes referred to as "shadow" adjustments.

Ed Robbins' articles, "Dealing with the New 'Shadow DAC'" (*Financial Reporter*, March 1994) and "Implementation Issues of the 'Shadow DAC'" (*Financial Reporter*, March 1995), as well as Allan Ryan's article, "FAS 115 Update" (*Financial Reporter*, August 1995), give excellent discussions of the shadow adjustment to DAC, and also consider methods of approximating the shadow DAC.

One rule of thumb that today appears to be in common practice for estimating the shadow DAC adjustment is to apply some sort of "average k-factor" to the unrealized holding gains or losses on assets available for sale. Such an average k-factor would presumably represent the marginal impact of a change in gross profits on the current DAC balance. This article, by way of a simple example, shows that the marginal impact of gains and losses on the DAC balance is affected dramatically by both the company's interest-crediting strategy and the age of the block of business. With such diverse factors affecting the marginal impact of gains and losses on DAC balances, this article concludes that the actuary should be wary when applying simple rules of thumb.

SPDA Example

The example is a single premium deferred annuity (SPDA) with the following characteristics:

- Single deposits = 10,000
- Deferrable acquisition costs (commission) = 400 at issue
- Current interest credited at issue is 5%, based on a target spread of 2%
- Net cash at issue is invested in 10 year 7% coupon bonds, purchased at par
- Withdrawals are 10% in years 1-9, with 100% withdrawal at the end of year 10
- Surrender charges are 4% in year 1, graded to 0% in years 5 and later
- There are no market value adjustment provisions
- There are no investment or maintenance expenses

Table I presents the expected development of the client balances over the 10-year life of the contracts, and Table II shows the expected gross profits and DAC amortization. Throughout this example, DAC amortization is assumed to be based on an interest rate equal to the then current credited rate.

Table I – Expected Development of the Client Fund

Yr.	BOY Fund	Deposits	5% Interest Credited	10% Withdrawal	EOY Fund
1	-	10,000	500	1,050	9,450
2	9,450	-	473	992	8,930
3	8,930	-	447	938	8,439
4	8,439	-	422	886	7,975
5	7,975	-	399	837	7,536
6	7,536	-	377	791	7,122
7	7,122	-	356	748	6,730
8	6,730	-	337	707	6,360
9	6,360	-	318	668	6,010
10	6,010	-	301	6,311	-

Table II - Expected Gross Profits and DAC Amortization

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC
1	-	42	200	242	230	347
2	-	30	189	219	198	299
3	-	19	179	197	170	255
4	-	9	169	178	146	214
5	-	-	159	159	125	177
6	-	-	151	151	112	140
7	-	-	142	142	101	104
8	-	-	135	135	91	69
9	-	-	127	127	82	34
10	-	-	120	120	74	(0)
	-	-	-	-	1,331	-
				Commisson:	400	
				k-factor=	30.1%	

The Interest Margin is equal to investment income earned at a rate of 7% on assets equal to the BOY Fund, less credited interest. Gross Profits equal the sum of Realized Gains, Surrender Charges and Interest Margin. EOY DAC is equal to the sum of the BOY DAC and deferrable expenses, accumulated with interest at 5%, less the DAC amortization, which is equal to the k-factor times the Gross Profits for the year.

Throughout this example we will assume that withdrawal rates remain at 10%, and there are no changes in the asset quality. Let us also assume that no changes occur in the interest environment for the first two years, and that the market value of the 10 year 7% coupon bonds is equal to the book value. But now let us suppose that at the end of year 3 the assets backing the net GAAP liability (EOY Fund less DAC) of 8,185 now have a market value of 8,641, which is based on a market value yield of 6%. Table III shows the development of investment income and capital gains, assuming the 6% interest environment remains constant after year 3, and that the assets are held to maturity. (In this example required capital is ignored, for ease of computation, so that the GAAP book profit represents the excess of cash flow over the amount required to maintain the GAAP net liability. Note that while “required capital” is a statutory concept, it is often used in allocating assets, and consequently earnings, to a block of business.)

Table III – Development of Investment Income and Gains

Yr	BOY BV Assets	Inv Income	Cash Surrender	Cash Flow	GAAP Book Profit	Net GAAP Liab = EOY BV Assets	Mkt Yield	EOY Mkt Val Assets	Unreal Gains
1	9,600	672	1,008	(336)	161	9,103	7%	9,103	-
2	9,103	637	962	(325)	146	8,631	7%	8,631	-
3	8,631	604	919	(315)	132	8,185	6%	8,641	457
4	8,185	573	877	(304)	119	7,761	6%	8,143	382
5	7,761	543	837	(294)	107	7,360	6%	7,670	310
6	7,360	515	791	(276)	102	6,982	6%	7,224	242
7	6,982	489	748	(259)	97	6,626	6%	6,803	177
8	6,626	464	707	(243)	92	6,291	6%	6,406	115
9	6,291	440	668	(227)	88	5,976	6%	6,032	56
10	5,976	418	6,311	(5,892)	83	-	6%	-	-

(continued on page 10, column 1)

Estimating the Impact of Realized Gains and Losses on DAC Amortization for Universal Life-Type Business
continued from page 9

Investment income equals 7% times the BOY Assets. GAAP Book Profit equals BOY Assets plus Cash Flow less EOY Net GAAP Liability, which is equivalent to the EOY Fund Value less DAC.

Effect of Crediting Strategy on the DAC Impact of Realized Gains

We now want to determine the impact on the DAC balance if the unrealized gains at the end of year 3 are then realized. One estimate is to take the gains of 457 and apply the k-factor of 30.1%, which results in 138 (a reduction in DAC). We know this estimate may tend to overstate the adjustment, because if the gains are realized, the k-factor will change somewhat.

But we also need to reassess future margins in light of the changes in expected future yield rates. Assuming the proceeds are reinvested in like vehicles, level coupon bonds maturing at the end of policy year 10, the investment return will be 6%. Therefore we need to know what crediting strategy the company will have going forward. Will it continue to credit 5%, thereby reducing its spread in future years to 1%? Or will it immediately adjust the spread back to 2% and credit 4%? Or perhaps it will slowly adjust the spread back to 2% over, say, 5 years. Tables IV, V, and VI show the impact on the DAC amortization under each of these three different crediting strategies.

Table IV – Case 1: No change in credited rate

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC	DAC Adj
1	-	42	200	242	230	349	-
2	-	30	189	219	198	302	-
3	457	19	179	654	565	125	(129)
4	-	9	84	93	77	104	(109)
5	-	-	80	80	62	86	(90)
6	-	-	75	75	56	68	(72)
7	-	-	71	71	51	51	(53)
8	-	-	67	67	46	34	(35)
9	-	-	64	64	41	17	(18)
10	-	-	60	60	37	0	0
					1,364		
			New k-factor =			29.3%	
			DAC Adjustment/Gains =			28.2%	
			Original k - Factor =			30.1%	

The Interest Margin above is equal, in the first three years, to 7% times the BOY Fund less credited interest. In years 4 and later, the rate is 6%. The DAC Adjustment is equal to the DAC from Table IV less the DAC from Table II.

Table V – Case 2: Change in credited rate to maintain spread immediately

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC	DAC Adj
1	-	42	200	242	230	364	
2	-	30	189	219	198	332	
3	457	19	179	654	565	197	(57)
4	-	9	169	178	147	164	(50)
5	-	-	158	158	126	134	(42)
6	-	-	148	148	114	106	(35)
7	-	-	138	138	102	78	(26)
8	-	-	130	130	92	51	(18)
9	-	-	121	121	83	25	(9)
10	-	-	113	113	75	(0)	0
					1,733		
			New k-factor =			23.1%	
			DAC Adjustment/Gains =			12.5%	
			Original k - Factor =			30.1%	

Table V is based on the same assumptions as Table IV except that the credited interest in years 4 and later is based on 4% instead of 5%.

Table VI – Case 3: Change in credited rate to maintain spread after 5 years

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC	DAC Adj
1	-	42	200	242	230	360	-
2	-	30	189	219	198	323	-
3	457	19	179	654	565	176	(78)
4	-	9	101	110	91	157	(57)
5	-	-	111	111	88	137	(40)
6	-	-	120	120	90	113	(28)
7	-	-	127	127	92	86	(19)
8	-	-	132	132	92	56	(13)
9	-	-	124	124	83	28	(7)
10	-	-	116	116	75	0	0
					1,604		
			New k-factor =			24.9%	
			DAC Adjustment/Gains =			17.2%	
			Original k - Factor =			30.1%	

(continued on page 12, column 1)

Estimating the Impact of Realized Gains and Losses on DAC Amortization for Universal Life-Type Business
continued from page 11

Table VI is based on the same assumptions as Table IV and Table V except that the credited interest in years 4 through 8 is 4.8%, 4.6%, 4.4%, 4.2% and 4% respectively. Interest in years 9 and 10 is also 4%.

As can be seen, there is considerable variation in the amount of the impact on DAC, ranging from 57, or 12.5% of the gains, to 129, or 28.2% of the gains. It should be noted that a thorough analysis of Case 2 and Case 3 above would consider the impact of changes in credited interest on the persistency of the business. For simplicity, here it has been assumed that there is no change in withdrawal rates.

Table VII – Development of Investment Income and Gains

Yr	BOY BV Assets	Inv Income	Cash Surrender	Cash Flow	GAAP Book Profit	Net GAAP Liab = EOY BV Assets	Mkt Yield	EOY Mkt Val Assets	Unreal Gains
1	9,600	672	1,008	(336)	161	9,103	7%	9,103	-
2	9,103	637	962	(325)	146	8,631	7%	8,631	-
3	8,631	604	919	(315)	132	8,185	7%	8,185	-
4	8,185	573	877	(304)	119	7,761	7%	7,761	-
5	7,761	543	837	(294)	107	7,360	7%	7,360	-
6	7,360	515	791	(276)	102	6,982	7%	6,982	-
7	6,982	489	748	(259)	97	6,626	7%	6,626	-
8	6,626	464	707	(243)	92	6,291	6%	6,406	115
9	6,291	440	668	(227)	88	5,976	6%	6,032	56
10	5,976	418	6,311	(5,892)	83	-	6%	-	-

Effect of Business Aging on the DAC Impact of Realized Gains

Now suppose that unrealized gains do not appear until the end of year 8, as shown in Table VII. The market value of the assets exceeds the book value by 115 (based on a 6% market yield).

If those gains are realized at the end of year 8, and the company's crediting strategy is to continue to credit 5% after year 8, then the impact on the DAC amortization is shown in Table VIII.

In this case the DAC adjustment as a percent of the realized gains is extremely close to the original k-factor. However, if the crediting strategy is to immediately maintain the original spread, the impact on DAC is much different — a decrease of only 2.8% of the realized gains (see Table IX).

Table VIII – Case 1: No change in credited rate; gains taken in year 8

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC	DAC Adj
1	-	42	200	242	230	347	-
2	-	30	189	219	198	299	-
3	-	19	179	197	170	255	0
4	-	9	169	178	146	214	0
5	-	-	159	159	125	177	0
6	-	-	151	151	112	140	0
7	-	-	142	142	101	104	0
8	115	-	135	250	169	35	(35)
9	-	-	64	64	41	17	(17)
10	-	-	60	60	37	-	0
					1,331		
			New k-factor =			30.0%	
			DAC Adjustment/Gains =			30.0%	
			Original k - Factor =			30.1%	

Table IX – Case 2: Credited rate changed to maintain spread; gains taken in year 8

Yr	Realized Gains	Surrender Charges	Interest Margin	Gross Profits	PV Gross Profits	EOY DAC	DAC Adj
1	-	42	200	242	230	351	
2	-	30	189	219	198	307	
3	-	19	179	197	170	266	12
4	-	9	169	178	146	229	15
5	-	-	159	159	125	195	19
6	-	-	151	151	112	163	22
7	-	-	142	142	101	130	26
8	115	-	135	250	169	66	(3)
9	-	-	127	127	83	32	(2)
10	-	-	119	119	75	0	0
					1,411		
			New k-factor =			28.4%	
			DAC Adjustment/Gains =			2.8%	
			Original k - Factor =			30.1%	

(continued on page 14, column 1)

Estimating the Impact of Realized Gains and Losses on DAC Amortization for Universal Life-Type Business
continued from page 13

Table X – Changes in DAC as a percent of gains taken

Year	Crediting Strategy 1	Crediting Strategy 2	Crediting Strategy 3
1	28.1%	17.1%	19.6%
2	28.1%	14.7%	18.2%
3	28.2%	12.5%	17.2%
4	28.5%	10.4%	16.6%
5	28.8%	8.5%	16.7%
6	29.1%	6.5%	17.8%
7	29.5%	4.7%	19.4%
8	30.0%	2.8%	21.7%
9	30.5%	1.1%	24.5%

Summary

It is clear that the size of the dampening effect of changes in DAC when gains or losses are realized can vary substantially depending on the age of the business and the company's interest crediting strategy. Table X summarizes, for this SPDA product, the DAC adjustment as a percent of the gains taken for each of the crediting strategies described above, when the gains are taken at the end of years 1-9, assuming a change in market yield to 6% at the end of the appropriate year.

For crediting strategy 1, when the company reduces its spread in order to continue crediting the same interest to the contract holders, the rule of thumb that the original k-factor approximates the ratio of the change in DAC to the gains taken is pretty good, though it generally overstates the DAC adjustment slightly. If the company's strategy is to always maintain its spreads even when large gains or losses occur, then the rule of thumb breaks down. In this case the variation by age of business is dramatic.

What these examples have demonstrated is that when capital gains or losses are timing differences (i.e. where the gain or loss will be essentially offset by future decreases or increases respectively in future margins), the rule of thumb for determining shadow DAC adjustments is a reasonable one. Likewise when realized gains or losses are taken, the k-factor will not be materially affected when the gains or losses are timing differences. In the case of unrealized gains and losses, the fact that the gains have not been realized tends to support a strategy of reducing the spread if the gains were to be realized. This may explain why the "rule of thumb" has found widespread acceptance.

For most companies, rerunning the DAC models to include potential gains or losses is not too large a task, and it is probably better to do this than to rely on some rule of thumb. In situations where rerunning the model is expensive or time-consuming, perhaps the actuary should test hypothetical gains or losses periodically in order to determine the marginal factor that best fits the company's crediting strategies and mix of business.

***Richard H Browne, FSA, MAAA, is a consulting actuary for KPMG LLP in Chicago. He can be reached at* rhbrowne@kpmg.com.**

Request for Proposal (RFP) — Financial Reporting Section Council

The purpose of the Life Insurance Company Financial Reporting Section is to encourage and facilitate the professional development of its members through activities such as meetings, seminars, research studies, and the generation and dissemination of literature in the field of life insurance company financial reporting. One of the functions of the Section Council, therefore, is to support the funding of such appropriate activities.

Purpose of the RFP

This RFP is intended to solicit requests for the funding of activities consistent with the objectives described above. It lays out requirements for consideration by the Section Council. Providing information meeting the requirements does not, in and of itself, mean that funding will be provided. However, a complete package is a prerequisite.

Specific Activity Variables

Please provide the following information so that the Financial Reporting Section Council can evaluate your funding request.

1. Briefly describe the activity for which this request is being made. Include the name or title of the project, if appropriate.

   ____
   ____

2. Briefly describe the purpose of the activity.

   ____
   ____

3. Briefly describe the benefits to be derived from the completion of this activity, including the product.

   ____
   ____

4. List the key members of the "activity team" and their qualifications for being involved in the activity.

   ____
   ____

5. Provide a plan for completion of the activity, including at least (a) steps in the project, (b) completion dates, and (c) periodic deliverables (if any).

   ____
   ____

6. Describe the anticipated financing requirements of the activity, including other potential sources of support.

   ____
   ____

7. What is the amount of financing you are requesting from the Financial Reporting Section?

   ____
   ____

CHAIR'S CORNER

by Mike McLaughlin

Ever notice how often the same names appear over and over again? I'm talking about presenters at Society meetings, seminar faculty members, and authors of articles and papers. Does it seem that some actuaries have a disproportionate share of the limelight? Why is that?

I'm not saying that this is always a bad thing. It is certainly a pleasure to hear a knowledgeable person speaking in an area of their expertise or read a well-thought-out idea in a paper or article. The value is particularly great in new or emerging areas. And, some people have a great deal to contribute.

This is no criticism of our leading participants. We appreciate and need the ideas of leading thinkers in the profession. On the other hand, after you have heard the same person's views two or three times on their favorite topic, a risk of repetition creeps in. Or even worse, other equally valid opinions are not being heard.

"It is certainly a pleasure to hear a knowledgeable person speaking in an area of their expertise or read a well-thought-out idea in a paper or article."

Our Section Council members have commented recently that it is difficult to recruit for SOA panels and seminars, unless they call back the same old stand-bys. Where is everybody else, and how do we find them?

Next question

In the February 2000 "Chair's Corner," I spoke about the Financial Reporting Section's strong sense of identity. The Section plays an active and important role in the Society of Actuaries, with meetings, seminars, the newsletter, funding of research and liaison with other groups within the Society, the Academy and other professions. I asked for members' comments on the ideal role for the Section to play. Here were the exact words:

> As a Section member, what do you think? Are we playing the right roles relative to volunteering, educating, and funding our own activities? How do these roles mesh with those of the Society? I anticipate active and continued discussion of these questions at future Council meetings and with other members of the Society. If you have an opinion, contact one of your Council members (listed in this newsletter).

And how many comments did I receive? Enough to send clear signals to the Section and Society leadership? Not hardly.

Final question

In the June 2000 "Chair's Corner" I spoke about many new areas of emerging importance to actuaries, including accounting, hedging, economic scenarios, behavior modeling, global markets, and financial engineering. As we grapple with these new areas, competing professionals are coming on to the scene with the knowledge and willingness to address many of these same areas. President-elect Rob Brown's Strategic Planning Committee has considered many of these issues and should help us considerably to adapt and grow into our new responsibilities. In fact, the Board will be discussing actions the SOA could take over the next several years to meet several goals, including attracting more strong candidates, alternative paths to qualification, and consideration of new credentials.

Should the shifting roles and responsibilities of the SOA and the Section be centrally planned and organized by "blue chip" committees such as this? (And it was a "blue chip" committee — except that your humble Section chairperson was included, most likely due to a horrible computer error somewhere.) Or should natural evolution take its course and individual members, one by one, shift over into non-traditional areas?

How do we tackle these questions and issues facing our profession?

The answers

It's pretty bold to answer real world questions, because they are always very complex. But I think we have an answer.

The answer is Section members. If we care, we have to get involved. Learn about the issues facing us as members of the Section, the Society, and the industry. Keep up to date on technical issues. Gain a broad view of how financial institution regulation impacts the economy, and how insurance companies interrelate with other financial institutions. Then act. Discuss the issues with your colleagues. Participate in discussion groups on the SOA Web site (*www.soa.org*). Write a letter to the editor of the *Financial Reporter*. Contribute articles to the newsletter or papers to the *North American Actuarial Journal (NAAJ)*. Become a panelist or workshop chairperson at SOA meetings. Serve on an SOA committee, of which there are many. Communicate to other professionals and members of your community about the actuarial profession. Contact your Section Council members. They are easy to find — why, some of them even know how to open their own e-mail.

Don't be like the actuary who was asked how we could cure ignorance and apathy. He said, "I don't know, and I don't care."

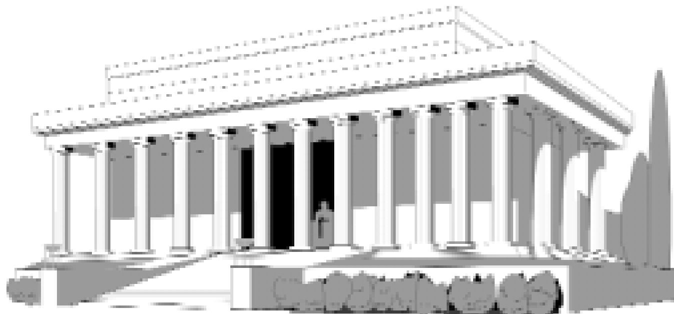
Join in. Your Section, your Society and you will benefit.

***Mike McLaughlin, ASA, is a partner with Ernst and Young LLP in Chicago, IL. He can be reached at* mike.mclaughlin@ey.com.**

Academy Seminar on Life and Health Qualifications Taking Shape

by Larry M. Gorski

Changes to the SOA Education and Examination syllabus are now a reality. One principle underlying the new syllabus was the removal of state-specific and country-specific material. A result of implementing this principle is that new Fellows may not fully meet the American Academy of Actuaries Specific Qualification Standards to sign the U.S. Statutory Actuarial Opinion on reserves. The Academy is addressing this issue by developing a seminar to address the gap between the American Academy of Actuaries Specific Qualification Standards and the knowledge acquired through the SOA examination process.



The Academy seminar is scheduled to start on Monday, November 13, 2000, in Washington D.C. and conclude on Thursday, November 16, with a three-hour open book examination. The seminar will cover:

- statutory insurance accounting
- valuation and nonforfeiture requirements
- expense analysis for health insurance.

Participants will be expected to have reviewed a substantial amount of material before the seminar, but there will not be a pre-test to screen seminar applicants. It is anticipated that the open book examination will consist largely of written-answer type questions.

Current thinking is that candidates who receive a passing grade on the open book examination may count the seminar as 15 formal Professional Development program units (SOA). Candidates attending the first three days of the seminar may count the seminar as 28.8 continuing education credit hours (Academy Qualification Standards) with an additional 3.6 hours of continuing education credit given for passing the open book examination.

For applications received by September 30, 2000, the cost for the seminar is $1,000 for Academy members and $1,300 for non-Academy members. For applications received after September 30, the cost is increased by $100. For seminar participants, study material can be purchased for $200.

Based on preliminary information, the seminar is anticipated to be interactive in nature with session leaders presenting an overview of a subject followed by facilitated discussions to further develop the topic. Topics expected to be covered include:

- the Standard Valuation Law and statutory reserving methods
- A&H reserving methods, Asset Adequacy methods
- product-specific reserving issues,
- reinsurance
- professionalism

To round out the seminar, evenings will be devoted to case studies on both life and health valuation issues.

More information concerning the seminar can be found on the Academy Web site *(http://www.actuary.org)*.

Larry M. Gorski, FSA, MAAA, is a life actuary at the Illinois Department of Insurance in Springfield and treasurer of the Financial Reporting Section. He can be reached at **Larry_Gorski@ins.state.il.us.**

Annual Meeting Preview

by Thomas Nace

The Annual Meeting of the Society of Actuaries will be held in Chicago on October 16-18. By now, members should have received materials on the meeting agenda and registration information. In the event that you are still undecided about your attendance, below is the current list of financial reporting sessions scheduled for the Annual Meeting. If you haven't signed up yet, maybe these sessions will encourage you to do so. But hurry, as time is running out.

Session	No.	Type	Date/Time
Purchase GAAP	5	PD	Oct. 16, 10:30 a.m.
Statutory Reserving Update – Annuity Products	6	PD	Oct. 16, 10:30 a.m.
Valuation and Financial Reporting of Long Term Care (LTC) Insurance	10	PD	Oct. 16, 10:30 a.m
Statutory Reserving Update – Life Products	32	PD	Oct. 16, 2:00 p.m.
GAAP Textbook Introduction	33	PD	Oct. 16, 2:00 p.m.
Financial Reporting Hot Breakfast	42	SM/PD	Oct. 17, 7:30 a.m.
Enterprise Risk Management	54	PD	Oct. 17, 8:30 a.m.
Managing Risk in Extreme Market Environments	66	PD	Oct. 17, 10:30 a.m.
GAAP for Nontraditional Products	67	PD	Oct. 17, 10:30 a.m.
Fair Value of Liabilities – a Debate	70	PD	Oct. 17, 10:30 a.m.
Banking and Insurance – Different Ways to Count the Same Beans	87	PD	Oct. 17, 2:30 p.m.
NAIC Actuarial Opinion	88	PD	Oct. 17, 2:30 p.m.
Accounting for Policyholder Dividends	117	PD	Oct. 18, 8:00 a.m.
Specific Qualification Standards for U.S. Statutory Actuarial Opinions	118	PD	Oct. 18, 8:00 a.m.
U.S. and Canadian Demutualizations – Postmortem	130	PD	Oct. 18, 10:00 a.m.
Recent Research Bearing on Fair Value Reporting, Solvency, Capital Levels And All That	133	PD	Oct. 18, 10:00 a.m.
Regulatory XXX: Implementation Issues	151	WS	Oct. 18, 12:00 noon

Session Descriptions

Editor's Note: for a complete listing of the topics to be covered at each session, refer to your Annual Meeting program. The following is a brief summary of the sessions and is not all-inclusive in terms of topics covered.

Purchase GAAP – This session focuses on GAAP methods and standards of practice applicable to the purchase of a block of business. Topics covered will include: determination of opening balance sheet, calculating and applying actuarial appraisal values, projection of GAAP profits, Pooling vs. Purchase PGAAP, the impact of marking assets to market, use of reinsurance and many other relevant topics.

Statutory Reserving Update – Annuity Products
Provides an overview of recent and potential developments in statutory reserving for annuity products including: variable annuities with guaranteed living benefits, guidelines 33, 34 and 35, GICs with bailouts triggered by downgrades, Guideline 9-a, changes to the AOMR and a UVS update.

Valuation and Financial Reporting of Long Term Care Insurance
Discusses the impact of the changing business and regulatory environment on valuation and financial reporting of long term care, in particular: RBC standards, recent codification standards, efforts to develop a new morbidity table for LTC and the consistency between valuation and pricing assumptions.

Statutory Reserving Update – Life Products
Provides an overview of recent and potential developments in statutory reserving for life insurance products including: Regulation XXX, Guaranteed Minimum Death Benefit Reserves for VUL products, draft Actuarial Guideline ZZZZ, revisions to AOMR, update on UVS and new CSO mortality tables, to name a few.

GAAP Textbook Introduction
This session provides insight into the contents of the new GAAP textbook by some of the authors, including a discussion of the authority behind GAAP, the ability to glean several practices where principles are not clearly defined and an overview of the key elements of GAAP for life companies.

Financial Reporting Hot Breakfast
Panelists provide an overview of recent developments in the areas of GAAP, statutory and tax financial reporting.

Enterprise Risk Management
Panelists for this session discuss case studies and measurement processes and how risk management translates to increased value for the enterprise. Attendees will obtain a greater appreciation for the complexity and pervasiveness of business risk as well as the emerging tools to quantify and balance risk.

Managing Risk in Extreme Market Environments
Discusses how to manage risks in extreme market environments that are beyond normal range of modeling assumptions. The application of extreme value theory to the analysis of insurance company risks provides insight to the weaknesses in models as well as tools to analyze the extreme “tail risk.”

GAAP for Nontraditional Products
This session deals with a variety of new exotic product types and the accounting profession’s attempts to provide guidance. Specifically covered will be: variable products with guaranteed benefits, equity-indexed products, market value-adjusted annuities, annuities with a front-end bonus feature and investment contracts with the interest spread as the sole source of profit.

Fair Value of Liabilities – a Debate
Panelists present the pros and cons of various approaches taken to measure the fair value of insurance liabilities. Attendees hear a discussion of fair value methods brought to life by proponents of each approach. Time for questions and comments from the attendees is provided.

Banking and Insurance – Different Ways to Count the Same Beans
With the convergence of banks and insurance companies as a result of recent financial services legislation, many new issues arise. This session will discuss how similar products sold through different regulated entities may give rise to significant differences in asset accounting, liability measurement, statutory restrictions, taxation and capital requirements.

NAIC Actuarial Opinion
Attendees are provided with an up-to-the-minute update of the new impending Actuarial Opinion and Memorandum Model Regulation and a discussion of the various changes proposed.

Accounting for Policyholder Dividends
This session explores alternative methods for the accounting recognition of the costs of policyholder dividends. The theoretical bases, as well as the impact on anticipated earnings patterns, are discussed.

AAA Specific Qualification Requirements for Statutory Actuarial Opinions
The Academy has modified the Specific Qualification Requirements for actuaries opining on the NAIC Life and Health Annual Statements. Panelists discuss the deliberations of the Academy Task Force, the underlying reasons for the change, and the structure and content of the resulting seminar and examination.

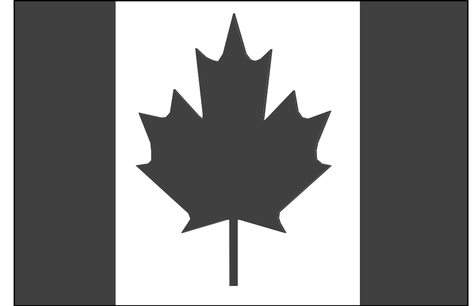
U.S. and Canadian Demutualizations – Postmortem
Representatives from companies that have demutualized over the last two years discuss the conversion process and the experience so far from operating as a public company.

Recent Research Bearing on Fair Value Reporting, Solvency, Capital Levels and All That
The panel discusses the research that has taken place that is most relevant to the afore-mentioned topics. In so doing, the session provides an awareness of the new techniques for approaching valuation and solvency issues in order to better handle possible new requirements and to be able to manage risk for your company or client.

Regulation XXX – Implementation Issues
The workshop will identify key implementation issues, discuss possible approaches to addressing the issues and if possible, identify “best” practices to address the issues. Among the issues to be discussed are developing new term products, choosing software, providing actuarial certifications and choosing the “X” Factor for the valuation mortality assumption.

Dynamic Capital Adequacy Testing: Lessons from the Canadian Experience

by Mike Lombardi



The formal assessment of the projected capital adequacy of insurers was established in Canada in the early 1990s. Although the value of the modeling process known today as Dynamic Capital Adequacy Testing, or DCAT, was not universally welcomed at the outset, over the years it has evolved into an important tool in the work of the Canadian appointed actuary.

Insurance Environment

To better understand the regulatory framework that led to the development of DCAT, it is useful to review some key features. Despite the geographic proximity, the insurance regulatory environment in Canada is quite dissimilar from that in the United States in many important ways:

- Insurance solvency regulation, except for a very small number of provincially registered companies, has always been a federal matter.
- There is normally no filing or approval process for new products and premiums.
- There are no nonforfeiture laws; cash values for life products are dictated by consumer preference and competitive pressures.
- Accumulation products such as deferred annuities tend not to have any book value guarantees. The interest rate risk on early surrender of a policy is normally charged directly to the policyholder as a market value adjustment.
- Reserves set up for statutory purposes must be the same as those set up for GAAP accounting purposes. These GAAP reserving principles apply equally to mutual and stock companies.
- An insurance guarantee association (CompCorp) exists to provide a floor of protection in the event of insurer insolvency.
- Insolvencies of life companies have been rare.
- The appointed actuary plays an important cornerstone role in the regulatory framework.
- The basis for determination of actuarial liabilities is not dictated by regulators.
- Actuarial liabilities are calculated from first principles based broadly on professional standards of practice and guidelines that emphasize use of the full policy premium, explicit assumptions, and a limited and reasonable additional margin in each assumption for adverse deviation.
- Unlike U.S. GAAP, where actuarial assumptions for traditional products are generally fixed at the time of policy issue, actuarial assumptions under the Policy Premium Method are not fixed but must be reviewed periodically in light of emerging experience and actuarial judgment.

DCAT Development

Prior to 1992, actuarial reserves were calculated on a modified net level reserve basis known as the 1978 Canadian Method, which permitted the deferral of acquisition costs of up to 150% of the net level valuation premium. Negative reserves and reserves less than cash values were permitted to flow through the income statement, but a balance sheet appropriation of surplus was required for these amounts. An appropriation of surplus was also required for the investment valuation reserve, which was based on net deficiencies of market values from book values on invested assets. The balance of surplus, called unappropriated surplus, was the measure used by the regulator in assessing solvency. The rule of thumb was that unappropriated surplus should not be less than 5% of liabilities.

A number of significant changes were made in 1992 to modernize the legislation governing federally regulated life insurers in Canada, the Insurance Companies Act (ICA). In particular, the reserving standards were modernized to a gross premium valuation method, the Policy Premium Method (PPM) and a single set of statement values serve both statutory and GAAP reporting purposes.

At the same time as a new reserve regime was being introduced, a modern solvency measure was put in place, the Minimum Continuing Capital and Surplus Requirement or MCCSR. The MCCSR structure, which formed the model for the later adoption of the RBC structure in the United States, provides a measure of a company's capital adequacy at a single point in time.

The MCCSR ratio is the key measure used in the DCAT process. It is defined as the ratio of the company's available surplus to its required surplus, both of which are defined based on formulas developed by the regulators. In general, available surplus is the company's capital and surplus, adjusted for unamortized gains or losses on supporting assets, increased by subordinated debt, and the market excess for assets supporting surplus, but reduced by certain items

such as a portion of the cash value deficiency reserves, negative reserves and goodwill. Required surplus is calculated using complex formulas that take into account the company's exposure to risks relating to asset default, interest rate fluctuation, mortality, morbidity, lapse rates and interest margin pricing.

Given the enhanced role and responsibility of the appointed actuary to monitor company solvency, a new tool was needed to measure company solvency on a prospective basis. DCAT addressed the deficiencies inherent in the use of a broad based static test of solvency:

- The MCCSR formula uses factors appropriate to the average company with average risks without recognizing individual circumstances of the company in question.
- A variety of risks to which the company may be exposed are not covered by the MCCSR formula.
- The formula is static, not recognizing sensitivities to changing conditions or company practices such as pricing, asset-liability management, dividend policies, or interest crediting strategy.

Requirements

The appointed actuary of each federally regulated life insurance company and, since January 1, 1999, each property and casualty company, is required under the ICA to perform an annual investigation of company solvency and to report those results to the company's board of directors. Normally, the report would also be presented to the company's management to provide an opportunity to discuss and react to the findings before its submission to the board of directors. The DCAT report must outline the investigations performed, along with any significant findings and conclusions. The preparation of the DCAT report is subject to the Canadian Institute of Actuaries (CIA) professional standards. The most recent CIA Standard of Practice on DCAT was approved in December 1998 and is effective for any DCAT work done since January 1, 1999.

The actuary's annual investigation of the company's solvency should consider the past, present, and future financial positions of the company and the sensitivity of surplus to changes in various experience factors and management policies. The appointed actuary should examine in detail the base scenario, normally consistent with the company's business plan, and at least three plausible scenarios posing the greatest risk to the satisfactory financial condition of the company.

The actuary is required to consider threats to capital adequacy from all categories of risk, including mortality, morbidity, persistency, cash flow mismatch, deterioration of asset values, new business, expense, reinsurance, government and political action, and off balance sheet items. Ripple effects of interdependent assumptions are to be considered, including regulatory action and policyholder action, as well as the insurer's expected response to adversity.

The analysis in practice involves projecting the company's operations for a period of approximately five years, and making such changes in reserve bases as indicated by anticipated emerging experience. The MCCSR ratio at the beginning of the period is compared to its expected value at the end of the projection period and conclusions are drawn about the viability of the company's current plan.

Management's response to adverse scenarios is particularly difficult to model. Assumptions must be made not only concerning the specific action of the company in response to the situation, but also of the timing and accuracy of the corrective actions. There may also be situations where regulatory response should be assumed to occur. If the company fails to meet the minimum regulatory capital requirement, regulatory action could restrict management's ability to manage the company, or result in prohibitions on the writing of new business.

DCAT reports must contain an opinion signed by the actuary on the financial condition of the insurer. According to the most recent CIA educational note on DCAT, an insurer may be considered to have a "satisfactory financial condition" if throughout the forecast period, it is able to meet all its future obligations under the base scenario and all plausible adverse scenarios, and the MCCSR ratio under the base scenario is at least 120%. This should not be confused with the target ratio, generally considered to be 150%, which is the minimum level required to avoid regulatory attention and intervention. Average industry MCCSR ratios are currently estimated to be in the 180% to 200% range.

DCAT vs. Cash Flow Testing

Although DCAT and U.S. cash flow testing share the same techniques of modeling and examination of scenarios, there are important differences:

- Cash flow testing examines interest scenarios; DCAT examines all risks to solvency.
- Cash flow testing is concerned with reserve adequacy and therefore ignores assets backing surplus; DCAT is concerned with corporate solvency and therefore all assets are considered.
- Cash flow testing looks at in-force policies; DCAT looks at both in-force and future new business.

Experience

For many companies, the initial effort required to comply with the original standard of practice proved to be difficult. Insurance companies were obliged to invest a great deal of time and effort into developing and validating the required financial modeling systems. In addition to a base scenario, representing the actuary's best estimate of future events, the original CIA standard specified that ten suggested scenarios be investigated over a period consistent with the company's internal business horizon, typically five years. Each suggested scenario was constructed by

(continued on page 22, column 1)

modifying only one variable in the base scenario, without allowing for the impact of mitigating changes in the other variables. Some questioned the relevance of the reporting requirements, particularly the testing of these unrealistic "isolated impact" scenarios. The CIA standard also indicated that the appointed actuary should investigate additional scenarios reflecting any risks specific to the company's circumstances.

In its early days, the primary purpose of dynamic capital adequacy testing was to enable the actuary to provide advice about trends in surplus and threats to the company's solvency, and to explore sensitivities of the company to changes in its economic environment. As the solvency testing process has evolved, the focus has become the identification of plausible, imminent threats to the company, and the actions of management that might lessen the likelihood of their occurrence, or which might mitigate those threats should they materialize.

Over the years, most life insurers have developed a good understanding of their risk profiles and have redirected their time and modeling efforts towards areas of greater relevance. The trend has been to move beyond the CIA-suggested scenarios and towards the use of integrated scenarios that are more realistic and comprehensive and allow for the consideration of "ripple" effects of changes in assumptions of related variables.

As experience with the DCAT process has evolved, actuaries have faced a number of interesting challenges. For example:

- Balancing between a sufficiently complex financial model and the use of reasonable approximations
- Explaining the relevancy of DCAT results in the face of mid-year changes in company business plans
- Obtaining expert advice outside the actuary's own area of expertise, for example, when modeling non-insurance subsidiaries, or complicated assets
- Delivering an appropriate level of detail of results to the various audiences of the DCAT report

Conclusion

Compliance with the DCAT Standards of Practice has affected life insurance companies in a number of ways. DCAT has led to increased responsibilities of the appointed actuary within the corporate planning process and increased communication with the board of directors. Efforts undertaken to develop the model and the myriad of necessary assumptions has led to improved integration among different departments and the formalization of consistent, company-wide business planning. The implementation of risk-monitoring and control systems, along with the development of five or more year financial model projection capabilities, have enabled companies to analyze the impact of operational, investment, and financial decisions with relative ease.

In terms of business strategy, there has also been a noticeable effect. The financial management of an insurance

Record Sessions for Financial Reporting Track Posted on the Web since the June *Financial Reporter*

Atlanta May 1999 Meeting

43TS The Forthcoming International Accounting Standards
Instructors discuss the move toward a uniform set of worldwide accounting standards, its progress, implementation deadlines and transitional rules.

85PD ASOP – No Fables
Panelists review all existing Actuarial Standards of Practice as they relate to U.S. life insurance financial reporting.

86PD Trends and Issues in Financial Institution Convergence
Experts discuss the major issues and trends as diverse sectors of the financial services industry meld together at increasingly rapid rates.

San Francisco October 1999 Annual Meeting

4PD Fair-Value Reporting – Is There a "Fairer" Way?
Panelists review emerging proposals for reporting liabilities at "fair value," including measures and objectives, its implications for the income statement and balance sheet and impact on asset/liability management.

32PD The Cost of Capital – Everything an Actuary Needs to Know
Panelists cover the determination and use of the cost of capital for both stock and mutual companies.

76PD Generally Accepted Accounting Principals for Nontraditional Products
Discussion deals with the many new exotic product types and the accounting profession's efforts to provide guidance, such as variable annuities with guaranteed living benefits, equity-indexed products, market value adjusted annuities, annuities with a front-end bonus feature and investment contracts with no significant source of profit other than interest spread.

77PD Mutual Companies – Extinct in Canada?
With Canada's largest mutuals converting to stock companies, discussion centers on its demutualization process and interesting differences between the companies and across borders, eligibility and the process for determining allocation of shareholder value.

99PD Purchase Generally Accepted Accounting Principles – Where Are We Heading?
Panelists discuss the accounting profession's attempts to codify areas long subject to a wide variety of practice, grappling for guidance with Accounting Principles Board Opinion 16 and Emerging Issues Task Force 92-9 Statement of Financial Accounting Standards 60 and 97.

125PD International Valuation – Coming Soon to a Country Near You
Panelists discuss how the efforts of several organizations to craft the next century's insurance valuation framework is reshaping the way we will do business in the future.

126PD The Actuary's Role in Risk Management
The panel discusses how the actuarial profession may contribute to the quantification and management of various types of risks that insurers and other financial service providers assume.

127PD Variable Annuities and Segregated Funds – Guaranteed Benefits Valuation Issues
Panelists offer a description of the guaranteed benefits offered in the U.S and Canada, comparing current valuation issues, including risk assessment, reserving, and cash-flow testing.

160F Recent and Planned Changes to Risk-Based Capital for Health Insurance Products
Panelists discuss the features of NAIC's new model regulation addressing risk-based capital for managed care organizations.

Letter to the Editor

Dear Tom:

The Financial Reporter has exhibited a great sense of timing in the pair of excellent articles by Jay Glacy covering the requirements of the new FAS133 statement. The neat and compact spreadsheet was particularly useful in understanding the points raised.

I'd like to comment on a couple of items.

Value of the Host Contract

An opening value is used for the Host Contract that causes the earnings at issue to be zero. Although this seems intuitively pleasing, there is nothing in GAAP literature that requires that earnings be zero at issue. I am also not comfortable with basing the value of the Host Contract on this principle alone; it seems too arbitrary. If the capital markets go crazy and the cost of hedging skyrockets, it does not seem right to balance an excessive option cost by understating the value of the Host Contract. In effect this defers recognition of volatility in the capital markets and defeats the purpose of FAS133.

I had thought for some time that the underlying guarantee ($9,000) should be the value of the host, but the 10% load creates a FAS97 Unearned Front-end Load (UFEL) liability of $1,000 on top of that, with the result that the starting balance sheet is negative by the cost of the hedging option. This doesn't seem right either.

Looking at the issue fundamentally, the Host Contract really consists of a series of guaranteed benefits, and the "real" value (fair value) of the host, consistent with the fair value Jay computed for the embedded option, should actually be the present value of the guaranteed benefit stream using best estimate assumptions. This seems more intuitively logical to me. There are a number of candidates for the discount rate, but if the Risk Free Rate is used for the Black Scholes calculation, it seems by analogy a reasonable rate for the value of the Host Contract.

Benefit Reserve Floor

I don't agree with the value used as a benefit reserve floor. The value used is the indexed account, but by the terms of the contract, there is no vesting until year 5. The highest floor value I would consider reasonable would be the guaranteed surrender value. If, however, this is intended to be FASB's second foray into Fair Value Accounting (I agree with the author's conclusion here), the concept of a floor may need to fade into the sunset as a relic of amortized cost accounting. This example does illustrate vividly the consequences of retaining the concept of a liability floor — an unreasonable result.

Thanks again to both of you for initiating discussion on this topic.

Sincerely,

Paul A. Hekman, FSA, MAAA

Author's Response

Paul Hekman's comments on my two FAS 133 articles provide the impetus for reaching much-needed clarity about the important accounting issues involved. This response to Paul's two items outlines the thinking behind my conclusions.

Value of the Host Contract

FAS 133 does not amend FAS 97. So in confronting the bifurcation issue, I observed the FAS 97 requirement that payments received by the insurance enterprise be reported as liabilities. Thus, the full deposit under the equity-indexed annuity would be recorded as the initial GAAP liability. Then, following Implementation Issue B6, the initial value of the host contract is determined as the balancing item between the deposit amount and the exogenously determined fair value of the embedded derivative. Issue B6 specifically discards bifurcation approaches that result in the recognition of an immediate gain or loss.

If the capital markets do in fact "go crazy," FAS 133 requires them to do so on both sides of the balance sheet. The initial value of the host contract would presumably parallel the value of the bond purchased with whatever monies remain after the purchase of the hedges, thus preserving accounting symmetry. In the situation Paul describes of "excessive option costs," the correct answer may be to ensure the product is correctly priced, thereby safeguarding the funding sufficiency of the bond.

Finally, since the host contract represents accounting recognition only of the guaranteed benefits contained in the EIA policy, it is correct to "impute" an accretion rate that equates these two items. (In the Black-Scholes formulation, the risk-free rate is only an artifice of the so-called risk-neutral valuation methodology involved. Risk neutrality does not attribute "best estimate" status to the risk-free rate.)

Benefit Reserve Floor

As above, FAS 97 requires the GAAP liability to originate at the deposit amount (in the absence of premium loads). In my example, since indexed-based interest is not credited until policy year 5, I accreted the "FAS 97 floor" to the same guaranteed benefit used for the host contract. (Some observers believe that EITF 86-28 also plays a role here.) I agree with Paul that the floor concept is a relic. Hopefully, emerging FAS 133 interpretations will clarify this situation.

Many thanks to Paul for a thoughtful and stimulating discussion.

Anson J. Glacy, Jr., ASA, CFA

Reinsurance and the Bottom Line

by Barry L. Shemin

The use of reinsurance has been growing and spreading, both in its traditional function of absorbing risk and in newer roles related to improving company financials or product profitability. Many actuaries, even those familiar with financial reporting or reinsurance, are not as expert as they would like to be when it comes to the financial reporting of reinsurance.

To this end, the Financial Reporting Section and Reinsurance Section agreed to co-sponsor a seminar on Financial Reporting for Reinsurance. The seminar was scheduled for Wednesday, September 13, 2000, in Washington, D.C., the day before the start of the Valuation Actuary Symposium.

The seminar was scheduled to cover Statutory and GAAP income statement and balance sheet reporting in depth, as well as special discussion of a number of topics of current interest. Ample time was alloted to addressing questions from participants.

Scheduled presenters included Bob Buckner, appointed actuary for the life subsidiaries of Employers Reinsurance Corporation; Eric Schuering of PricewaterhouseCoopers, author of the reinsurance section of the upcoming GAAP textbook; and Steve Zonca, vice president and chief actuary at RGA/Swiss Financial Group. Each presenter has extensive experience in the financial reporting of reinsurance.

This seminar has been approved for six units of professional development credit.

For more details, see the SOA Web site *(http://www.soa.org)* and look under *Meetings and Seminars*.

***Barry L. Shemin, FSA, MAAA, is senior vice president & corporate actuary at John Hancock Life Insurance Company in Boston, MA. He is a Council member of the Financial Reporting Section. He can be reached at* bshemin@jhancock.com.**

GAAP Textbook to be Unveiled at Annual Meeting

by Shirley Shao

Our Section will be sponsoring two events to celebrate the introduction of the *US GAAP for Life Insurers* textbook at the SOA annual meeting. Both events will take place on Monday, October 16, 2000:

- **#33 PD session** (2:00 p.m.-3:30 pm): Each author will present the highlights of the chapters while the editor and others will give some general background on the origins of this new book.
- **Reception** (6:30 pm-8 pm): We will have a book signing at the reception. This will be a great opportunity to meet the authors in person and collect a complete set of signatures from all authors.

Please come to join in the celebration, congratulate the authors (they really deserve your pat on the back), hear all about the experience and buy one or more books.

When I proposed a new GAAP textbook to our Section Council three years ago, everyone on the Council thought it was a good idea (not all my proposals have generated this same reaction). While they all recognized the need, they also quickly pointed out that this may be an aspirational goal — roughly translated to "just a dream."

It probably would have remained a dream if Tom Herget had not agreed to be the editor and project manager of this book.

Tom started the process a year and a half ago with detailed business plans. His plans were both creative and practical — an absolute must for this difficult task. Moreover, his plans were aggressive by many standards. I have to confess that even I, as an optimist, had doubts about completing a book of this nature in 15 months. Now that I look back, Tom actually executed his plans pretty much in line with the way he originally anticipated. I am by no means saying that everything was smooth sailing. It was incredible for me to witness the number of contingency plans Tom devised to address the mile-long list of issues. Most of all, he has been an inspirational leader for the team.

It probably would have remained a dream had the authors not agreed to write this book. Fortunately, nine prominent experts shared the same dream. Frank Buck, Dan Kunesh, Tom Kochis, Mike McLaughlin, Ed Robbins, Dave Rogers, Eric Schuering, Brad Smith, and Jay Zellner agreed to devote a substantial effort in writing this book. It was very challenging to perform comprehensive research, decide what is most relevant, write it up in simple English, come up with meaningful examples to illustrate critical concepts, debate the gray areas where GAAP principles are not clear, and coordinate with other authors on who is supposed to do what. Every author commented that this writing process was much more painful and longer than they ever anticipated. Still, they valued this very fulfilling experience in making a significant contribution to the profession and cherished the opportunity to work with each other.

It probably would have remained a dream had the Financial Reporting Section Council not agreed to take on this task. After all, this is the first time our Section sponsored and published a textbook.

Now, we need you to fulfill the last part of the dream: become a reader of this great book. You can order this book by :

- Coming to the Chicago meeting to obtain one in person
- Filling out the order form in this issue of the *Financial Reporter*
- Downloading the order form from our Section's Web site and fax it or mail it in

We look forward to seeing you at the two celebrated events in Chicago. Happy reading!

***Shirley Shao, FSA, MAAA, is vice president and associate actuary at Prudential Life Insurance Company in Newark, NJ. She can be reached at* shirley.shao@prudential.com.**

GAAP Textbook to be Unveiled at Annual Meeting!

by Shirley Shao

Order Form: *U.S. GAAP for Life Insurers*

Name ___________________________________ Daytime Phone ______________________________

Company ________________________________ Email ______________________________________
(Use only if order is to be shipped to company address)

Address ________________________________ Apt/Suite # __________________________________
(Please use street address; we cannot deliver to a PO Box)

City _______________ State/Province ________ Zip/Postal Code __________

Country ___________

Name on Credit Card ____
(If different from above)

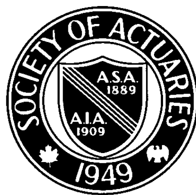
VISA/MasterCard/American Express # ____
(circle one)

Exp. Date ___________________

Signature ____

COST ITEMS	U.S. DOLLARS	
U.S. GAAP for Life Insurers	$100.00	**Send check to:** Society of Actuaries, PO Box 95668, Chicago, IL 60694
Taxes Canadian orders (7% GST) Illinois Orders (8.25%)	______	
Subtotal	______	**Send Visa/MasterCard or American Express information to:**
Number of Books	______	Society of Actuaries, Books and Publications Dept., 475 N. Martingale Rd, Suite # 800, Schaumburg, IL 60173, Fax (847) 706-3599
Total	______	
[4-53-0103]		

If you have any questions about your order, call the Society of Actuaries Books and Publications Department at (847) 706-3526.



475 N. Martingale Road, Suite #800
Schaumburg, IL 60173
Phone: 847-706-3500
Fax: 847-706-3599
Website: *www.soa.org*