Article from:

The Financial Reporter

September 2001 – Issue 47

CHAIR'S CORNER

by Michael V. Eckman

This month's Chair's Corner is definitely an editorial in which I state my own opinion and not necessarily that of my company or the Section. I hope that it generates some thought and discussion.

For many months, I have had the wonderful distraction of a new office building being built across the street from me. I find that the planning and just-in-time delivery of the construction material to be very fascinating. As each two-floor segment is finished, a new shipment of I-beams and other material arrives. The I-beams are hoisted by a crane up to their proper position and bolted into place. Cross members are connected, floor beams are laid, and the building takes shape.

Each of the heavy pieces of steel appears to fit just right. All of the many holes in the I-beams are drilled just right so that the construction looks from my vantagepoint to be as easy as putting Legos together. I only wish that our financial reporting systems, especially statutory, were planned with such care and forethought. We have long dealt with statutory, tax, and GAAP reporting. Each of these has its own purpose and rules. Many companies also use embedded value and asset liability management models to help assess risk. We are now discussing, studying, and some are proposing fair value and international accounting standards.

For many years, the Academy of Actuaries has been considering a Unified Valuation System (UVS) that is probably the closest we will come to the type of planning that goes into a new building. I think that unless statutory accounting does get an overhaul, the actuarial profession will suffer. As more and more complicated patches are applied to the current system and each state presses its own agenda, management will consider statutory accounting more of an obstacle to be overcome than a tool of value. The current trend in regulation with multiple actuarial guidelines and separate opinions and certifications for new products will turn the actuary into someone who is forced to be more concerned about the detailed wording of the laws than the nature of the risk the company has taken on.

Consider Regulation XXX. The second version of this regulation was adopted in 1999 after many years of debate and the belief that the problems of the original had been overcome. First, not all of the states have adopted it. Second, not all of the states that adopted it use the same wording or interpret it the same way. Third, companies responded by designing new products to specifically avoid the provisions of the law. One reason for the desire for circumvention was that the companies thought that the reserves resulting from Regulation XXX were redundant.

Now, consider the financial reporting, valuation, and appointed actuaries' roles in applying Regulation XXX. Instead of concentrating on the risks that the company has assumed in issuing a certain product, the actuaries have to be concerned with each state's version of the law and X factor testing. Try explaining the non-decreasing requirement for X factors to a management that has seen mortality improvements.

Consider Codification. As its name implies, this was an attempt to standardize some statutory accounting principles. But, all of the existing valuation laws remain in place. Codification requires the disclosure of any company's variance from the codification rules. KPMG's analysis of the June meeting of the NAIC reported that the Emerging Accounting Issues Working Group (EAIWG) considered SSAP No. 51. The discussion focused on "the proper reporting under Appendix A-205 for the situation where a state requires a higher standard, such as a more conservative mortality table, than the SSAP 51 and Appendix A-820 requirements, or the situation where a company chooses a higher standard even when not required by their state. The EAIWG reached tentative consensus that any reserve amount calculated on a state prescribed or permitted valuation basis that is materially different (either higher or lower) from the reserve amount calculated on the A-820 valuation basis must be disclosed." If you hold a materially higher reserve than required by the standard valuation law (A-820), you have to disclose the amount of additional reserve. It is a little like traveling through a small town and being stopped by the local sheriff because you were driving 25 MPH in a 30 MPH zone.

Now put codification and Regulation XXX together. Codification contains Regulation XXX. Earlier this year, there was discussion as to whether this meant that a state adopting Codification was, in effect, adopting Regulation XXX. The answer currently appears to be no. But if you hold Regulation XXX reserves and your state of domicile does not require that you do, you have to disclose the amount of the additional reserve.

Instead of spending our time discussing the detailed wording of each state's valuation law, we should be determining the appropriate reserve and capital for the risk we underwrite. If we are too busy dealing with the details of the valuation law, tax law, GAAP accounting, and other details, management will find someone else to do it. As well intentioned as the various opinions and certifications are, providing multiple opinions and certifications is not going to earn either actuaries or state regulators credibility.

I would like to see something come of UVS. There are many obstacles to overcome, including tax considerations. If we cannot come up with a type of UVS, I fear that management will just consider statutory valuation to be a compliance exercise and an obstacle to be overcome. Management may look to someone other than the appointed or valuation actuary for help in making business decisions that involve risk.

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