Be sure of it—international accounting standards ARE coming!

by Henry Siegel

“A specter is haunting Europe—the specter of communism!” – Karl Marx, 1848

“A specter is haunting Europe—the specter of fair value accounting!” – H.S., 2004

Fair value accounting is the core concept underlying the effort by the International Accounting Standards Board (IASB) to develop an internationally accepted accounting standard for insurance companies. For those actuaries who are involved in trying to implement the first stages of fair value accounting as well as those working to help define the ultimate fair value accounting, the specter is a reality.

International Accounting Standards are coming. They are being promulgated by the International Accounting Standards Board (IASB) and welcomed by the Financial Accounting Standards Board (FASB) (although not without a review). When the IASB is done, we may need to change our entire accounting structure for public accounting. And the result may be more confusing and less meaningful than US GAAP today.

Who is the IASB?
The IASB’s predecessor organization, the IASC, was founded in 1973 by the professional accounting organizations of several countries, including the AICPA of the United States, to promulgate a set of international accounting standards. In 2002 it was reorganized into the current IASB which is funded by a private foundation set up for this purpose. The foundation’s Board of Trustees is currently chaired by Paul Volcker and is made up of internationally recognized financial experts.

So who cares what the IASB says? After all, in the United States it’s the SEC and the FASB who set public accounting standards.

Well today it’s primarily the European-based companies who care. Why? Ultimately, the IASB derives its authority from the local regulatory authorities that agree to accept its rules. In this instance, the European Union (EU) has stated that all public companies listed on an EU stock exchange must report their earnings using International Financial Reporting Standards (IFRS) adopted by the IASB beginning in 2005. So if you’re a publicly traded EU company, you care right now.

How does this affect U.S. companies?

Obviously, if you work for a subsidiary of an EU company, you already know how it affects you. If you work for a U.S. company with an EU subsidiary, you might care if that subsidiary is listed separately or if local statutory reporting follows IASB as it does in some countries. But if you’re only doing business in the United States, you don’t have to do anything—yet.
Expect demand for actuaries to pick up!

by Morris Fishman

For those of you who worry about the slackening demand for actuaries, fear not. The accountants and actuaries full employment act of 2005, better known as IAS Phase I, will be here in 2005. A believable timeframe? All right then, let’s make it 2007. Still doesn’t seem like a logical probability? Okay, how about a Phase II? Realistically, as difficult as it is to make accurate forecasts that far into the future, don’t be surprised to see a Phase III before this project is finalized.

When reading the articles in this month’s edition of The Actuary, please keep in mind that things change quickly in the world of International Accounting Standards, and much of what you read may turn out to be valuable historical insight by the time this edition reaches you. Change is inevitable when one tries to unify worldwide accounting standards, especially when the work is so controversial.

Why is the work of the International Accounting Standards Board (IASB) so controversial? In my opinion, there are several reasons. First, it is different, materially different than the way United States and Canadian life insurance companies currently report earnings. Of course, actuaries in the United States, other than consultants, weren’t that excited about GAAP when it was first introduced in the United States over 30 years ago. In fact, an editorial that appeared in the January 1972 issue of this publication offered the following opinion of US GAAP: “Based on a limited exposure to GAAP, we have not been impressed. Some of the principles seem to be of the ‘Be sure to make and record an accurate count of the spoons’ variety.’” Think of all the spoons we have accumulated in the last 30 years!

US GAAP was also very different that its predecessor, US Statutory. It codified variations to US Statutory that had started to appear in the financial statements of some insurance companies. Now that most current and former mutual companies have also adopted GAAP, it has become the accepted, if not universally loved, standard for reporting earnings in the United States. Canadian actuaries seem to be more content with their reporting method, which, to this non-Canadian, seem to be similar to US GAAP, but with logical improvements.

Second, International Accounting Standards as they currently stand will change some very basic definitions, or at least add definitions for IAS purposes. We will have one more definition of a life insurance contract. We will also have a new definition of insurance risk. If that weren’t enough, we already have many new acronyms to confuse outsiders, like IASB, IAS 32 and 39, ED 5, not to mention IFRSs, MVMs and DIGs.

When confronted with something of this nature, my instincts are to go back to the original objective, and then assess the need and reasons for change. While statutory accounting is designed for solvency purposes and GAAP to report earnings on a basis consistent with other industries, International Accounting Standards appear designed to produce an appraisal value. Life cycle accounting designers feel it would be an improvement if US GAAP were to emphasize the smoothness of reported earnings from one period to the next.

The major reason stated for International Accounting Standards is to produce consistent financial reporting of insurance enterprises, first among the European Union, then the world.

Will International Accounting Standards accomplish their purpose? Do you like the way things are heading? If not, now is the time to act. We have been given a couple more years to implement these new accounting standards. When they come, watch out!

In any event, expect demand for actuaries to pick up. Remember, before US GAAP, no actuaries were employed by any of the “Big 8” accounting firms.
Be sure of it—international accounting standards ARE coming

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But international standards are coming. How?

Well, first of all, FASB has publicly committed itself to achieving convergence with international standards. Bob Herz, current chairman of FASB, was a member of the IASB when he was chosen to head FASB. You can draw your own conclusion as to what this means. And FASB and IASB are well along to achieving convergence in areas outside the insurance arena.

Chairman Herz has stated that FASB will review carefully whatever the IASB comes out with on insurance accounting and won’t adopt anything without due process. Nevertheless convergence is very likely to occur.

So where do things stand?
The IASB is well along to developing a standard for insurance that is materially different from US GAAP. And if you want to affect the process, now is nearly too late to get involved.

The IASB is approaching the subject in two phases. Initially, they wanted to just have one phase but it became clear early on that this was impossible, both because of theoretical issues that needed to be worked out and opposition from the industry, particularly from EU companies.

As a result, the exposure draft is brief and includes the following components:

- There is a new definition of a life insurance contract.
- There are new disclosure requirements.
- There are certain limited accounting changes that generally do not affect life insurers materially. The most important requirement—and this is one you might recognize—is that all embedded derivatives that are not themselves insurance contracts have to be held at fair value. Think FAS 133, SOP 03-1, DIG Issue B36.
- Insurance liabilities are based on Local GAAP. This was the key provision that characterizes Phase I.
- Assets are covered by IAS 39, a very controversial standard that is similar to FAS 115 and allows the same three choices—held to maturity, available for sale and trading.
- Fair value of liabilities will be a disclosure item in 2006, one year before Phase II is expected to take place.

There are a few other parts but, since only a few U.S. companies, those with EU parents, are or will be affected by Phase I, I’m not going to go into them. However, I do want to discuss a little further the first two items because they’ll carry over to Phase II.

What’s in Phase I?
Up to now, there has been no international standard for insurance liabilities. Phase I was added to allow a standard that could be implemented for 2005; accordingly, the goal was to mandate as few changes from current practice as possible.

What is a life insurance contract?
The definition of a life insurance contract is: A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary.

There are two problems with this definition and I’ve highlighted them. The first is the word “significant.” This means, well, you kind of know what this means, but it is rather vague. This is different from the definition used in U.S. statutory accounting where it’s “any” insurance risk. While some object to this definition, I think we can probably live with it.

The second problem is the definition of “insurance risk.” The exposure draft starts by defining financial risk: “Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.” Sounds like the small print in an automobile warrantee!
Well, now for the definition of insurance risk: Risk, other than financial risk! The key implication of all these definitions is that some products we think of as insurance products will be treated as though they were just financial products—like a bank deposit. A plain vanilla deferred annuity is one example of this; a GIC is another. This is similar to the treatment of an investment contract under FAS 97.

On the other hand, a deferred annuity with a Guaranteed Minimum Death Benefit attached would be an insurance contract. This could lead to considerable implementation confusion since two policies issued on the same policy form could be either an investment contract or an insurance contract depending on what side benefits it might have attached.

There are many people who are objecting to this definition for one reason or another but it’s likely to remain essentially as is—and it’s probably not too bad.

**Disclosures**

Disclosure is the second area where Phase I is expected to carry over to Phase II. There are three principles of disclosure in Phase I.

You have to explain your reported amounts. This means disclosing your accounting assumptions and how you arrived at any assumptions (including actuarial assumptions) you made. For instance, is it based on industry experience or the company’s own experience? Is it intended to be conservative or best estimate? What future trends are assumed?

“Quantified disclosure” of those assumptions is expected when practicable. This could mean disclosing your mortality assumptions, lapse assumptions, discount rates and others, with some aggregation allowed.

Disclosing sensitivity to changes in assumptions is also required. You would be expected to disclose how different your reserves and earnings would be if you assumed higher or lower mortality, or a change in the discount rate.

The second principle is you have to explain the amount, timing and uncertainty of cash flows. Again, assumptions must be disclosed and sensitivities shown. This disclosure should be consistent with how management views the company. So if you have a number of segments, you may have to show sensitivities for all of them if material.

You have to disclose your risk management objectives and how you mitigate risk including among other items, underwriting rules. Again, disclosure of sensitivity analysis is important.

The exposure draft also calls for a summary of how cash flows would change if policyholders exercise whatever options they have.

And there’s more, but I don’t have space to cover all the issues here. The bottom line is that the disclosures requirements will be extensive and cover many items that are not currently in your 10(k)s today, some of which you might even consider proprietary.

The good news is that in response to comments received, the Board is considering making the disclosures more optional than the current wording. As of this writing, however, it’s not known how this will end up.

The third principle, disclosure of fair value in 2006, is under review after significant opposition from the industry as premature. It’s possible that this will be removed from Phase I in the final standard.

Now these are all just proposals and won’t apply to the United States since FASB has stated it won’t adopt Phase I. So to some extent we can sit back and watch what the EU companies do with these requirements. It should be interesting.

**Phase II**

But Phase II will be coming and work is starting on that now. While the Chairman of the IASB, Sir David Tweedie, has stated publicly that the Board has not made up its mind on most aspects of Phase II, the “Basis for Conclusions on Phase I” published by the Board, contains “Tentative Conclusions” on Phase II that outline fairly clearly where the Board is headed.

Phase II will include a reporting structure based on an asset/liability approach rather than the deferral and matching approach of US GAAP. Fair value of assets and liabilities is required. Future cash flows are only includable in specific situations and there is no deferral of acquisition costs.

Now we might all agree that the market value for a security is the proper value to put on a balance sheet, all other things being equal. Surely, that’s what we look at when we consider the value of our personal portfolios. However, do you want the assets and liabilities on your corporate balance sheet measured in that way? Think about the potential for significant volatility from measuring period to measuring period.

The American Council of Life Insurers has worked with the International
Actuarial Association to illustrate the problems that measuring assets and liabilities on different bases can cause (e.g., assets on held to maturity with liabilities on fair value). There are problems even if interest rates don’t change since the yield curve at any point in time is not level. If you want to know more about this, you should log onto the IAA Web site at www.actuaries.org.

Another basic problem is that there is no such thing as a market value for an insurance liability. They are simply not traded. Accordingly, what we’ll have is a modeled value and this is where we actuaries fit in.

The Board is leaning towards a proposal in which insurance liabilities (that is, reserves) will be based on actuarial models using best estimates of the various assumptions. Market Value Margins (MVMs) will be added to provide some conservatism. There is expected to be no gain at issue of a contract (although there can be and often will be a significant loss). The discount rate used will be based on the risk free rate and the company’s own credit rating. Overall, the Board is hoping that these models will produce a proxy for a fair value of the liabilities, but we know it’s only an actuarial modeled value.

Just developing a deterministic model might not be too bad, but it appears that the IASB is going to require stochastic evaluation of all risks to be sure that all embedded derivatives are included. Not too many companies are prepared to do stochastic models of all their business.

Problems with Phase II
I want to conclude with two specific issues that I think will be major problems with regard to Phase II.

First is the recognition issue. Specifically, the Board has not decided the extent to which renewal premiums may be included in reserve calculations. If renewals are not included (and they aren’t today in most P&C businesses), then the effects on the pattern of earnings will be material. Since we assume there will be renewal premiums in pricing, not using them for liabilities will distort things significantly. And the Board is leaning towards allowing only a limited recognition of renewal premiums.

Second, the concept of using a company’s own credit rating to determine the discount rate for reserves is very controversial. On its face, it means that the lower the company’s rating, the higher the discount rate should be and, therefore, the lower the reserve. Another way of thinking about this is if your rating is lower, the probability that you’ll actually pay off your liabilities is lower. So if your equity is too low, get downgraded so reserves will go down (because you’ll use a higher discount rate) and equity will go up!

Now this is not completely true because you’re expected to take into account guarantee associations and regulatory requirements to determine the real probability that a policyholder benefit won’t be paid. Nevertheless, this concept has caused considerable concern among commentators.

This is by no means a complete exposition on fair value accounting or International Financial Reporting Standards as proposed by the IASB. Discussions are ongoing and there are indications the Board may be close to recognizing some of the problems with their current proposals. For instance, at their December meeting the IASB discussed removing the requirement to show fair value of liabilities in 2006 and to make the disclosure material more at the discretion of the reporting entity. They are also discussing methods to ameliorate the asset/liability mismatch problem.

How it will turn out is still not clear. If you just want to follow the issue, the IASB’s Web site (www.iasc.org.uk) is another good place to visit periodically. But now is the time to get involved through the IAA, the ACLI or other interested parties. We are always in need of new insight and ideas.

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Be aware before you share...

The SOA has received reports from some members who have received unsolicited telephone calls from people claiming to be associated with the Society. These individuals request information about actuarial students interning or working at insurance companies for upcoming exam dates, for example.

Before you share details with anyone claiming to be affiliated with the Society, get a name and verify SOA contact information, including telephone number and e-mail address. If a caller is legitimate, he/she will be willing to provide this information. If not, you’ll probably get a dial tone. To be safe, ask for a callback number and visit the SOA Web site—www.soa.org—to verify Society membership or SOA staff status.
A third possible path for accounting principles

by Daniel F. Case

After expressing surprise that the International Accounting Standards Board (IASB) is pressing forward with its proposed standard, I suggest consideration of a very different alternative to present-day accounting principles.

I gather that the IASB’s proposed standard for insurance businesses is based on current values—perhaps the ones that are called “fair value” in the United States. Virtually no other business—mutual funds being an exception because of their nature—is on a current-value basis in the United States or, presumably, elsewhere. Adopting the IASB’s proposed insurance standard would create a basic inconsistency between insurance reporting and that of other businesses, such as manufacturers and retailers.

Only 30 or 35 years ago, much work was done in the United States to bring the reporting of stock life insurers into line with that of other businesses. It surprises me that an authoritative body would now want to make insurance reporting basically inconsistent with everyone else’s methods. I believe that the IASB should not adopt a new standard for insurance unless and until it decides on a universally consistent basis.

If one-time charges occur very often, however, they can become a significant part of the overall picture.

Why seek a third possible path?

Present-day accounting for businesses generally—in the United States and, presumably, elsewhere—is fundamentally flawed. Some assets are carried at historical-cost-related values, while others are carried at current values, such as fair values. As a result of that inconsistency, financial reports are neither fish nor fowl.

One example of the inconsistency is the writing down of assets to their current values under certain circumstances, while assets are not written up under the opposite circumstances. For the sake of example, let’s say a company has an operation that is performing better than expected and one that is performing below expectations. The company may report substantial one-time charges, such as asset writedowns, associated with the second operation. It reports no offsetting one-time credits for the first operation. Meanwhile, another company with two operations, each of which is performing about as well as expected, will neither write up nor write down. Although the overall performances of the two companies may be quite similar, their reported earnings will exhibit very different patterns because of the one-time charges.

There appears to be a tendency among investors to discount the significance of one-time charges and to concentrate instead on the pattern of ongoing earnings. Certainly, it can be reassuring to know that the trend of ongoing earnings is favorable. If one-time charges occur very often, however, they can become a significant part of the overall picture.

Since one-time charges are derived from current values, while ongoing earnings derive mostly from historical-cost-related values, the cause of investor uncertainty over one-time charges is the mixing of the two types of value.

A second, related flaw in present-day accounting shows itself upon the sale of an asset that has been carried on a historical-cost-related basis. In most reporting, the realized gain or loss is instantaneously recognized, even though the mere sale or exchange of an asset for its fair value does not change the value of the enterprise in a way that is related to the size of the gain or loss.

Changes made by the Financial Accounting Standards Board (FASB) have moved United States reporting in the direction of current-value accounting. If the FASB goes all the way to current-value accounting, it can mend both the above-mentioned flaws, since carrying assets at current values should greatly reduce the size of realized gains and losses. To mend both flaws, it would be necessary to carry both individual assets and whole operations or divisions at current value, since any of those can be sold. Liabilities would also be carried at current values—whether fair values or something else, I need not address here.

Current-value accounting would have some obvious advantages. Everyone would like to have an expert opinion of the value of an enterprise. Such a reporting basis would, however, seem to provide an appraisal rather than an accounting. Reported income would equal the change in the appraised value of the enterprise during the period. There would have to be a complete appraisal as of each reporting date.

There may be a need for financial reports that give an accounting and not an appraisal. I have explored such a set of accounting principles that suffers minimally from the two flaws of present-day accounting mentioned above. Following is a brief description of those principles, highly condensed from a book-length study I have written. I call the principles “life-cycle accounting principles,” for reasons that will become apparent. I offer the principles as a possible alternative to present-day accounting and current-value accounting.
Life-cycle accounting principles—securities

Under life-cycle accounting principles (L-CAP), current values are used as little as possible. For a debt holding, for example, the amortization schedule established at time of purchase is followed without change until sale, restructuring or maturity. The expected risk of default is built into the schedule at the start, by use of an expected yield rate instead of a rate based on the contractual payments. No separate allowance or reserve for the risk of default is carried.

A possible rule for determining the expected yield rate under a debt holding starts with a risk-free rate promulgated by the accounting authorities for the particular type of debt instrument involved. To that risk-free rate is added a prescribed portion—representing the risk premium paid by the issuer—of the difference between the risk-free rate and the rate based directly on the purchase price and contractual payments.

Upon the sale or exchange of a debt holding, the realized gain or loss is neutralized in a way resembling what the interest maintenance reserve (IMR) accomplishes in regulatory reporting for life insurers. While the IMR neutralizes only the effect of the change in market interest rates since the debt holding was acquired, L-CAP also neutralizes any change in the perceived level of default risk since that time. L-CAP’s neutralizing formula, called the “income-adjustment formula,” brings the amount of the realized gain or loss into reported income over the remaining time to maturity of the original holding. In each period following the sale, the formula makes (a) the income that will be reported if the reinvested proceeds yield a level rate of return at the expected yield rate implicit in the transaction equal (b) the income that would have been expected to be reported if the original holding had been kept instead of sold.

Debt obligations, as distinguished from holdings, are handled in a similar fashion, except that no risk of default is reflected in either the amortization schedule or the income-adjustment formula.

From the material presented above, it can be seen that L-CAP focuses on the contractual lifetime of a debt instrument rather than on the time during which the reporting enterprise owns the instrument. The name, “life-cycle accounting principles” derives in part from that fact. Additional support for the name can be found in L-CAP’s treatment of operations, described later in this article.

L-CAP values common-stock holdings—of whatever size—by a method that starts with the traditional “equity” method. The reported income from the holding in each period before it is sold includes the holder’s share of the most recently available reported income of the issuing company. The carrying amount of the holding is increased by that amount and decreased by the amount of any dividend received. In addition, any difference between the price paid for the holding and the holding’s share of the stockholders’ equity on the issuer’s books at the time of purchase—called “goodwill” positive or negative—is amortized over a span of time. The amortization schedule is designed to produce a constant rate of reported return on the investment if things go as was expected at the time of the purchase.

The assumption behind the pattern of goodwill amortization is that the amount of goodwill reflects the buyer’s and seller’s expectations for the issuer’s reported yield rates on stockholder’s equity during the timespan chosen. In the case of positive goodwill, for example, L-CAP assumes that the expected issuer yield rates grade smoothly down into an ultimate rate at the end of the timespan. The actual period-by-period amortizations depend on the amount of goodwill, the length of the timespan, the ultimate yield rate chosen and the expected pattern of dividend rates. Application of the method might require the use of some standard rules and, perhaps also, prescribed tables.

Upon the sale of a common-stock holding, L-CAP applies the income-adjustment formula that it uses for debt holdings, adapted to suit common stocks. For example, the yield rate newly expected as of the time of sale of a debt holding becomes the newly chosen ultimate yield rate for the stock holding; the newly projected cash flows from a debt holding become the newly assumed dividends; and the time to maturity becomes the timespan chosen for the writeoff of the gain or loss.

Life-cycle accounting principles—operations

L-CAP’s treatment of debt instruments and common stocks, described earlier, centers on the concept of constant expected reported rate of return on the investment. L-CAP applies the same concept to operations, such as manufacturing operations. The concept is applied to an operation as a whole.

The carrying amount of a manufacturing operation as of its start-up time is the capitalized value of its plant, equipment, materials inventory and certain other items, determined essentially as in pres-

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ent-day accounting. L-CAP’s special treat-
ment of the operation applies to the
operation’s lifetime subsequent to its
start-up.

As of the start-up time, a projection is
made of the further cash flows anticipated
during the lifetime of the operation. The
cash flows include, for example, inflows
from sales and outflows for wages and
benefits, maintenance and replacement of
equipment and the settlement of product
liability claims. The projected cash flows
do not include any that are associated
with indebtedness incurred in support of
the operation. The indebtedness is
accounted for separately and has no bear-
ing on the accounting for the operation as
such.

From the cash-flow projection, a
projected internal rate of return (IRR) is
determined. That IRR is then used, in
combination with the projected cash
flows, to calculate a projected carrying
amount for the operation as a whole as of
each future reporting date. Those carrying
amounts would produce a constant
reported rate of return on the investment
in the operation, during its lifetime, if
everything were to go exactly as projected.

In addition to the projected amounts
noted previously, reported values for
assets of four types—property, plant,
equipment and inventory—are projected.
It will be found, of course, that the
projected carrying amounts for the entire
operation differ significantly from the
total projected reported values of the four
types of asset mentioned above. Typically,
the operation’s carrying amounts will
exceed the four-asset totals during the
early and middle stages of the operation,
when sales still lag behind the pace of
investment.

Actual balance sheets will show reported
values for each of the four asset groups.
L-CAP wants, however, to show a value of
the operation as a whole that reflects the
overall cash-flow projection. It does that
by including in the balance sheet, as of
each actual reporting date, an amount
equaling the difference between the
projected overall carrying amount and the
projected total four-asset reported value
for that reporting date. This difference at
each reporting date is called the “opera-
tional phase balance (OPB).” A certain
modification of this amount, described a
bit later in this article, must be made
before it is actually used.

The values of the four asset groups that
are actually reported at each reporting
date are based on the property, plant,
equipment and inventory that have actu-
ally been acquired or developed for the
operation, rather than what had been
projected. The OPBs, however, are
reported unchanged from the amounts
that were determined from the original
projection. L-CAP values individual
assets, such as plant, equipment and
inventory, in ways not very different from
the present-day treatment, except that
depreciation schedules are followed with-
out change, regardless of how well or how
badly the business is going.

In the case of an insurance operation, the
projected cash flows include, for example,
inflows for premium payments and
outflows for benefits and expenses. They
do not include any cash flows associated
with the investments supporting the op-
eration. The investments are accounted for
separately and have no bearing on the
accounting for the operation, apart from
the fact that the IRR produced by the
cash-flow projection mentioned previ-
ously must bear a reasonable relation to
the yield anticipated from the invest-
ments.

Since, under L-CAP, the projected cash
flows of an insurance operation are
predominantly negative, the IRR is nega-
tive. The calculation of the OPBs is,
nevertheless, similar to that for other
operations. They equal the difference, at
each reporting date, between the
projected overall carrying amount for the
operation and the projected reported
values of the major components. In the
case of life insurance, the major compo-
nents are blocks of policies, the reported
values of which are based on reserve
factors applied to the actual inforce. The
factors for each type of policy are deter-
mined prior to issue and are used without
change over the lifetime of the policies
involved.

An operation that is projected to last for \( n \)
years will most certainly not, of course,
last exactly that long. Its expected lifetime
is a weighted average of many possible
lifetimes. Cash-flow projections for opera-
tions of various possible lifetimes will
differ from one another in many respects.
OPBs based on an expected—i.e.,
weighted average—cash flow will differ
markedly from OPBs based on a single
projection. L-CAP needs OPBs based on
expected, not projected, cash flows.

Sophisticated stochastic techniques could
be brought to bear on this problem.
L-CAP is, however, intended for use by
enterprises of all sizes. Accordingly,
L-CAP’s method of determining the
desired OPBs is to determine the
projected OPBs and then refer to a set of
standard tables to be promulgated by the
accounting authorities. The tables would
indicate how to convert the projected
OPBs to the desired ones. The tables
would have to take into account many
variables, such as the projected lifetime of
the operation, the pattern of the projected
OPBs, and, perhaps, the characteristics of
the business of which the operation is a
part. Developing the tables might involve
stochastic techniques. In any event, the
OPBs used in the balance sheet are to be
determined by reference to standard
tables.

If an operation is sold, a projection is
made of the cash flows during the
remaining lifetime of the operation which

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Richard Geisler elected president of NZ Society of Actuaries

Richard Geisler, MAAA, FSA, chief actuary at Accident Compensation Corporation (ACC) in Wellington, New Zealand, was elected president of the New Zealand Society of Actuaries (NZ SoA).

“Richard’s appointment is a public recognition of the excellent standing he has in his profession and with his colleagues at ACC,” said Garry Wilson, ACC chief executive.

Geisler has been chief actuary for ACC since August 2001. He will serve as the NZ SoA president for a one-year term.

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Do you know an SOA member who shines? Who goes above and beyond to advance or promote the actuarial profession? Who inspires others to “raise the bar” and give 120 percent? Here’s your opportunity to give that person his or her day in the sun.

This year, we will be publishing special achievements of SOA members in a new feature called “Members in the spotlight.” We’re looking for information about people who:

- Advance or build the actuarial profession in a significant way.
- Demonstrate a high level of dedication and commitment to the actuarial profession.
- Inspire others to strive for excellence in the actuarial profession.
- Impact a large number of people in the actuarial profession.
- Impart knowledge or introduce new topics related to the actuarial profession.

“Members in the spotlight” is dedicated to highlighting the achievements of SOA members whose commitment and value to the profession have earned them special notoriety. Note that personal information such as job promotions, retirements, academic degrees or accreditations earned, weddings, births, etc. is not the focus of this new feature. Please keep that in mind when submitting accomplishments or successes about an SOA member you’d like to see highlighted.

Guidelines
All submissions should highlight successes about an SOA member and should be limited to two to three paragraphs. Every entry will be considered and will be edited as necessary—please note that submission of an entry does not guarantee publication. Photos will also be considered if space is available.

We’re excited about this new feature in The Actuary and look forward to recognizing the special accomplishments of our members. Please send submissions for “Members in the spotlight” to Jacque Kirkwood at jkirkwood@soa.org.

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Register now for the 29th Enrolled Actuaries Meeting!
It’s hard to believe we are 29! The 29th annual Enrolled Actuaries Meeting at the Marriott Wardman Park Hotel in Washington, D.C. is scheduled for March 21-24, 2004.

As always, the meeting’s general sessions this year will explore timely topics that are relevant to all enrolled actuaries, such as discussions of some recent court decisions, Precept 8 of the Code of Professional Conduct and the future of defined benefit plans. Our concurrent sessions have something for everyone, from discussions of restricted lump sums to a panel on cash balance plans. You will have several opportunities to interact with personnel from the Internal Revenue Service and the Pension Benefit Guaranty Corp.—traditional attractions of the EA Meeting. The meeting committee is also keeping up with proposed legislation that affects funding requirements and will offer relevant sessions in those areas as they develop.

For the Monday luncheon speakers, we are pleased to have Tucker Carlson and James Carville. Both are co-hosts of CNN’s “Crossfire”—they should provide lively political commentary for this election year.

The EA meeting is a great place to keep up with our ever-changing profession and a wonderful opportunity to network. Since this is the last year of the cycle, keep in mind that you can satisfy half of your EA continuing education requirements when you attend. Register today at www.ccactuaries.org!
Point, counterpoint...  
Actuaries discuss the major issues of IAS

There are several schools of thought on the need for and impact of International Accounting Standards (IAS). Some argue that the limited understanding of those setting the process in motion may be detrimental to the insurance arena. Others contend IAS could represent a step backwards in the world of accounting. There are also those who are on the fence regarding the subject, waiting for further explanations and decisions as to what accounting system changes will be necessary in their respective businesses.

While the definition of fair value is conceptually clear, it is not at all clear how it can be applied in practice to insurance assets and liabilities. Fair value is a problem in another way. While the definition of fair value is conceptually clear, it is not at all clear how it can be applied in practice to insurance assets and liabilities. Fair value is “The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.” Since such transactions seldom occur, and because most of those are in a context of unequal bargaining power, it is difficult to see how fair value valuation techniques may be calibrated to market behaviour. In this vacuum, a variety of rules, such as the surrender value floor and no profit or loss at issue, are being proposed, yet are incompatible with the concept of fair value.

Returning to the definition, the fair value of a liability can be thought of as comprising the expected present value of future payments under that liability, with whatever adjustments the hypothetical market participants would make for the risks inherent in that present value: amount, timing, credit and other items.

But, what is the proper accounting treatment? Reducing the recognized value of liabilities for the risk of inadequacy implies a fortiori reducing the value for any certainty of inadequacy, and no entity could ever be accounted for as insolvent! My own conclusion is that, for accounting purposes, a modified version of fair value should be adopted.

Buchanan: The biggest problem is that the standard setting process is being controlled by people with a limited understanding of either life or general insurance. This comes out in a number of ways.

Perhaps the most subtle, but also the most fundamental of these, is that the International Accounting Standards Board (IASB) has established and is trying to work within a Framework for the Preparation and Presentation of Financial Statements. This is based on an essentially deterministic view of the world, which is difficult to reconcile with the stochastic nature of insurance, particularly general insurance. There is an assumption that everything can be measured, when the best that we can hope for in many cases is an estimate. There is also binary choice: recognize or don’t recognize, when either choice is a poor reflection of the expected value and uncertainty.

Another problem in the framework is that consistent measurement of different quantities is not addressed, even when the key result is their difference. As a result, it is not seen as inconsistent with the framework for assets to be measured at fair value and liabilities amortized, or vice versa, as allowed under the proposed changes to IAS 32/39, which governs financial instruments other than insurance. This issue has been raised with the IASB by the International Actuarial Association (IAA), using a joint IAA/American Council of Life Insurers (ACLI) study which demonstrates what we have known for a long time: if you take away apples from oranges, the answer is bananas.

Fair value is a problem in another way.

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Buck: The major issue for life insurance companies is reconciling the emergence of profit under IAS with profit emergence under US GAAP, Canadian PPM (Policy Premium Method), European GAAP and other global systems. Under both the U.S. and Canadian approaches,
profit at outset is small, possibly negative, and, provided experience is similar to the initial assumptions, emerges smoothly over the lifetime of the business. Under the European approach, the majority of the profit emerges in the first year or two.

Under fair value, it could be argued that most of the profit could be reported at outset. This may be acceptable for European products, which tend to have covered their initial costs during the first two years, but could result in volatile earnings for U.S. products, where this is not the case.

The second major issue is defining "fair value." A small change in certain assumptions can have a major impact on the present value of long-term cash flows and trying to get a system that is globally consistent will be a challenge. Should the assumptions be company or territory based? What is the basis for the expected assumption? Who determines the level of margins for adverse deviation? Will there be somewhat rigid rules or will companies (and their auditors) have wide discretion?

Chambers: This question can be broken into two parts corresponding to the two-phase approach that the IASB has adopted to deal with financial reporting for insurance contracts.

Phase I is to be implemented for 2005 when Europe will be required to use IAS. Unfortunately, what is proposed for Phase I is, in my view, a mess. It mixes historical cost methods with prospective methods so that there is a high potential for inconsistency in the measurement of assets and liabilities, and it imposes artificial constraints on the valuation of liabilities.

Meanwhile, the IASB will be working on Phase II, its ultimate financial reporting approach, widely expected to be a move to fair value methods. Unfortunately again, I fear that there are a number of problems with the IASB's interpretation of its definition of "fair value of liabilities" for insurance contracts (or for any other financial instrument, for that matter). We could probably spend the rest of this and several more issues of The Actuary debating that basic element.

For my part, I see the principal problems as (a) incorporation of "own credit risk" and (b) use of risk free discount rates. If both of these are adopted, the result may not be too bad, but it will be "not too bad" for the wrong reasons, and I've never accepted that two "wrongs" make a "right." The other danger is that in Phase II the whole concept may be perverted by the imposition of artificial constraints such as the "deposit floor." If that happens, the goal of generating meaningful financial statements for insurance contracts will have been lost. In fact, if such constraints do emerge, I would argue that actuaries would be compelled to provide qualified opinions because our code of professional conduct requires us not to be associated with statements that are false or misleading.

What are the implications from IAS to your organization or insurance organizations in your region?

Buchanan: Life insurance accounting is governed by Australian Accounting Standards Board (AASB) 1038. The liability valuation embodies the Margin on Services (MoS) valuation approach. Very briefly, this takes a deferral and matching approach to the recognition of profit, but uses current assumptions for mortality, lapse/surrender expenses and discounting. Assets must be recognized at market value.

While it is conceptually based on deferral and matching, MoS is not greatly different to fair value. The main difference is that fair value adds a market value margin to the central estimate of the net liability, where MoS adds the unearned balance of the loaded profit margin. It can be argued that, unless the loaded profit margin is materially different from what would be charged in the notional fair value transaction, MoS is a very good proxy for fair value.

General Insurance

General (P & C) insurance accounting is governed by AASB 1023. The premium liability basis is Unearned Premiums minus Deferred Acquisition Cost, subject to a limited (DAC ≥ 0) loss recognition test. The claim liability basis is expected present value using a current market-determined discount rate. A risk margin is regarded as good practice (main exception: HIH) but not supported by AASB 1023.

(Note: HIH Insurance, which once ranked as Australia’s second largest general insurer, collapsed in 2001, affecting millions of small investors and policy holders.)

The regulatory requirement changed from July 1, 2001. Under AASB standard GPS 210, the premium and claim liabilities are both determined on an expected present value basis, using a current “risk-free” discount rate, with a risk margin intended to give a 75 percent probability of adequacy. It is my belief that this is a rather good proxy for fair value and that, barring major theoretical advances, the only likely improvement in this regard is better calibration of the adequacy level to the market.

Buck: As an accounting firm, our clients in the United States are aware of IAS, but have not made much progress in adopting it. They are waiting for more decisions to be reached and for the Securities and Exchange Commission to decide what approach will be accepted and the implementation date. The companies will have to invest in new systems and understand the different results. In many cases, remuneration systems will have to be changed.

In Asia, there is a much greater awareness. Many new local accounting pronouncements follow IAS, so that a lot of IAS has been adopted already. The local subsidiaries of global companies are currently planning ways to adopt IAS, so that they will be ready when it becomes a requirement.

Chambers: My region is Canada. It is widely acknowledged that Canada’s current financial reporting system for insurance is as close as any in the world to what was originally proposed by the IASB working party. Consequently, it would have been relatively painless for...
Canada to move to IAS. However, if Phase II—as eventually adopted—is tainted by the issues I have identified earlier, then it would be a retrograde step for Canada to adopt IAS. That would not be in the interest of the Canadian public and I would hope that it would be resisted and avoided.

**Have you adopted any form/degree of IAS?**

**Buchanan:** Australia intends to adopt IAS in 2005. It has been pointed out that, in some cases, particularly insurance, IAS could represent a backwards step. There are some signs, such as a restriction to fair value, for assets backing insurance liabilities under IAS 39, and for policy liabilities valued under IAS 39, that IAS may be modified when current Australian accounting standards are more advanced.

**Buck:** No. We are a private partnership providing professional services and do not have to report our results. I am not aware of any of our U.S. clients adopting IAS at this time.

**Chambers:** As I noted earlier, Canada has not adopted IAS, though there is currently a proposal by the Canadian Accounting Standards Board, as part of the commitment to global accounting convergence, to adopt a change to our accounting rules for assets. As currently drafted, this would degrade the financial reporting of Canadian insurers and we are hoping to have the proposal modified before its adoption.

At the same time, because the larger Canadian insurers are international players, they will undoubtedly be affected by IAS when those standards are implemented.

**Is there a likely timeframe for a company to implement IAS?**

**Buchanan:** Given a clear working definition of fair value, I do not expect any great difficulty or delay in implementing fair value in Australia for general insurance classes that are currently valued actuarially. Whether this also applies to life insurance depends on how far this working definition departs from the current MoS technology. If the main differences relate to the determination of the market value margin, the problems should be manageable. For general insurance classes that use case estimates, however, it may take some time to relate these to fair value.

Because comparative figures are required, however, implementation will take at least one year longer. The 2005 deadline for disclosing fair value would be extremely tight if the working definition came out tomorrow. If we have to wait until next year or later, as seems likely, it will be next to impossible.

Other disclosures are also likely to be a problem, particularly disclosure of valuation approach and assumptions and the impact of changes in assumptions. There are two issues here. The first is that some smaller general insurers, reporting case estimates only, may not be familiar with the concept of valuation assumptions, let alone changes in those assumptions. This should not be an issue for life or general insurance actuaries. The second is the sheer volume of information implied by the current draft guidance. This could be overwhelming, particularly in general insurance.

**Buck:** This will depend on the size and complexity of the company’s business and the current level of information technology. Much also depends on whether existing systems can be adapted or whether a new system will be required. In many ways, it will be easier to adopt IAS than US GAAP, because we are likely to have one model rather than separate approaches for traditional non-par, universal life and investment contracts. However, calculating fair value will make it a lot more complex. A medium-sized company is unlikely to complete the process in less than one year and it could take significantly longer.

**Chambers:** As of November 2003, the European Union (EU) has identified 2005 as the date for adoption of IAS. Thus, any Canadian company with European operations and reporting requirements will be subject to that accounting regime at that time. However, it is my understanding that Caribbean accounting rules are already under the IAS umbrella. Thus, any company with reporting obligations in that sector will be required to use IAS this year. That’s a bit of a challenge since IAS reporting for insurance contracts has not been decided.

**Which accounting framework (local, IAS, other nations, etc.) do you prefer and why?**

**Buchanan:** It is my belief that the current Australian accounting standards are the world’s best practice, although there are still some problems with the general insurance standard that became obvious with the collapse of HIH. These problems have, to a large extent, been overridden by new prudential standards and are currently being fixed in the accounting standards.

The general valuation approach in both life and general insurance is expected present value, using a current discount rate, plus an appropriate margin for risk and uncertainty. This is compared to assets at market value. This satisfies my prime criterion for sound valuation: consistency between assets and liabilities. (It is worth noting that, although unearned premium is a deferral and matching concept, the premiums on...
which it is based are, at least implicitly, based on expected present value and, therefore, consistent with market value.)

This is pretty consistent with what the IASB proposed in its Insurance Issues Paper, so I was happy with what was proposed there. My main concern was with the demarcation issues vis-à-vis other financial instruments, but this concern was allayed by the uniform proposal to use fair value. This concern is now much greater, since the IASB backed away from fair value for financial instruments, and I am also concerned that the IASB may end up not only allowing, but even requiring inconsistent valuation of assets and liabilities.

**Buck:** My Canadian clients and colleagues will be surprised to learn that I prefer the Canadian PPM system. It is one model for all types of business; it holds a net liability; acquisition costs are not deferred; it allows profits to emerge over the lifetime of the business; it allows for realistic assumptions (with margins for adverse deviation); it is acceptable for both GAAP and statutory results; and it does not have a disjointed cumulative catch up for interest sensitive business.

I wish I could have said US GAAP, because it has given me an income for many years, but I think PPM is more logical.

**Chambers:** I’m afraid that this is going to appear to be jingoistic national fervor, but I believe that Canada got it right in 1992 and has been setting the global standard for insurance financial reporting for the past decade. Our approach, the Canadian Asset/Liability Method (CALM), is a prospective approach involving continuing review and updating of assumptions and incorporates consistent measurement of assets and liabilities. In my view, it produces meaningful financial reports that represent business reality.

**What can we as actuaries do to affect the final outcome?**

**Buchanan:** The International Actuarial Association and a number of national associations have active committees that are liaising with the IASB and promoting better understanding of the actuarial issues underlying insurance accounting. It is important that we all support this endeavor. This is particularly important for casualty actuaries because, just as bankers tend to dominate the debate on financial instruments, without proper understanding of the insurance issues, so life insurance actuaries tend to dominate the actuarial debate on insurance accounting, without a proper appreciation of the issues that are important for general insurance.

At an individual level, two things are important. The first is to take an interest in the debate and try to understand the issues. The second is to try to educate your management and accounting colleagues, so that they can make a positive contribution.

This is important, because too few of those actively involved have a good feeling for the nature of insurance and, hence, what is likely to be the result of particular proposals. Compared to insurance, banking products are simple. Things that work in banking do not always work for insurance. Rules derived for insurance, on the other hand, can usually be simplified successfully for banking.

Education of management is particularly important, because few professions have as good a grasp of the dynamics of insurance as do actuaries.

**Buck:** I suggest preparing models to show how profits will emerge for our major products under various future scenarios. Are the resulting patterns acceptable? Do they make sense? Show how the results are different for major products under various future scenarios. Are the resulting patterns acceptable? Do they make sense? Show how the results are different for major products. Send the results to members of committees reviewing IAS—actuaries, accountants and others—so that they are informed about the ramifications of the new system, before they finalize the approach.

**Chambers:** I wish I knew! Certainly, through the activities of the IAA, actuaries have had a significant influence already. Many of the elements of the “Draft Statement of Principles” that was prepared last year by the IASB staff were heavily influenced by IAA input. Paul McCrossan has, over that past six years, done a fantastic job of presenting, promoting, and informing the actuarial view in IASB circles. Paul is currently the IAA’s representative on the IASB’s Standards Advisory Committee. In that capacity, however, he is the only actuary and the only spokesman for the insurance sector on a committee of about 45.

We hope that the research done jointly by the IAA and the ACLI will have an effect on what is implemented for Phase I. That work clearly demonstrated the misleading results that can arise from inconsistent treatment of assets and liabilities.

Most importantly, though, I think all actuaries who are involved in financial reporting for insurers must educate themselves regarding these developments. It’s too easy to say, “It can’t happen here.” While it may take a number of years before these matters affect exclusively domestic U.S. companies, for U.S. and Canadian companies with international operations and for North American subsidiaries of European companies these are immediate issues that are likely to affect our work as early as next year. Come to think of it, it should also be of interest to pension actuaries because the IASB has indicated that, when insurance contract standards are in place, it intends to revisit its standards for post-employment benefits to ensure that they are consistent.

Morris Fishman, principal and consultant, Insurance Strategies Consulting LLC, Clearwater, Florida, and Michael Gabon, president, AIRCO Ltd, Hamilton, Bermuda, assembled the panel and coordinated and asked the questions included in this discussion. Fishman can be reached at Morris.Fishman@prodigy.net. Gabon can be reached at Michael.Gabon@aig.com.
Get a grip!
International accounting standards soon to take hold

by Jim Renz

Since the release of SFAS 133 “Accounting for Derivative Instruments and Hedging Activities” in June 1998, actuaries in the United States have had to deal with the most complex guidance ever issued by the Financial Accounting Standards Board (FASB). The effects of this guidance are felt on the investment side, the liability side, and most recently, on certain reinsurance contracts (e.g., DIG Issue B36 - Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments That Incorporate Credit Risk Exposures That Are Unrelated or Only Partially Related to the Creditworthiness of the Obligor under Those Instruments).

While many international actuaries are practicing in countries that follow US GAAP, many others practice in countries that follow international accounting standards. For these actuaries, accounting guidance for financial instruments is contained in IAS 32 – “Financial Instruments: Disclosure and Presentation” and IAS 39 – “Financial Instruments: Recognition and Measurement.”

Actuaries at U.S. companies that do not have a global presence typically have not been concerned with international accounting standards. However, that level of concern will soon have to change. In October 2002, the FASB entered into an agreement with the International Accounting Standards Board (IASB) to work toward convergence of U.S. and international accounting standards. The agreement requires both Boards to use their best efforts to propose changes to U.S. and international accounting standards that reflect common solutions to certain specifically identified differences. Working within each Board’s due process procedures, the FASB and IASB expect to issue an exposure draft to address identified differences. The elimination of those differences, together with the commitment by both Boards to eliminate or reduce remaining differences through continued progress on joint projects and coordination of future work programs, will improve comparability of financial statements across national jurisdictions.

IAS 32 and IAS 39 contain guidance that is very similar to the guidance contained in both SFAS 133 and SFAS 115 “Accounting for Certain Investments in Debt and Equity Securities.” Understanding the guidance in SFAS 133 and SFAS 115 will give one a great head start in dealing with international accounting standards regarding financial instruments. There are, however, differences that need to be recognized between the two. Some examples of these differences are contained in the table on page 15.

In August 2003, the IASB released ED 5 Insurance Contracts for comment with an expected finalization date of March 2004. The guidance contained in ED 5 will potentially lead to other differences. The scope exception for insurance risk is subtly different, which may lead to different conclusions as to the requirement to bifurcate an embedded derivative.

While there is no immediate impact on U.S. companies due to the differences in these standards, the day of international accounting standards is rapidly approaching. Companies will need to be aware of the provisions of any potential new guidance and how they may affect their business decisions. For many companies, this new guidance will impact product design as well as investment management. Companies that take the proper steps to understand the guidance in advance will be in the best position when international accounting standards take hold.

Jim Renz is senior accountant at the American Council of Life Insurers in Washington, D.C. He can be reached at jimrenz@acli.com.

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Volunteers are needed to edit sessions from The Record—the SOA’s written publication of presentations from the spring and annual meetings. You choose the meeting(s) in which you would like to participate and your area of specialty. You also get first crack at transcripts before they are posted online!

For more information, contact Glenda Greenberg, associate editor, at ggreenberg@soa.org or 847.706.3564.
A derivative is defined as a financial instrument with all of the following characteristics:

1. Its value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index or prices or rates, a credit rating or credit index or other variable.

2. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

3. It is settled at a future date.

Transaction costs are included in the initial measurement of all financial instruments.

If an entity is prohibited from classifying financial assets as held-to-maturity due to having previously sold some HTM assets before maturity, creating a “tainted” portfolio, that prohibition expires at the end of the second financial year following the premature sales.

A financial asset is derecognized if the transferee has the right to sell or pledge the asset and the transferor does not have the right to reacquire the transferred assets.

Use of non-cash hedging instruments is restricted to exposure to hedges of any risk of gain or loss from changes in foreign currency exchange rates in fair value hedges, cash flow hedges or hedges of a net investment in a foreign entity.

A hedge of an unrecognized firm commitment to buy or sell an asset at a fixed price in the entity's reporting currency is accounted for as a cash flow hedge.

Accounting for a cash flow hedge will be on a net basis on the balance sheet.

Three different types of host contracts are identified: debt, equity and insurance contract.

A derivative is substantially similar with the exception that the instrument's terms require or permit net settlement.

Additionally, FAS 133 indicates that the derivative contains notional amounts and/or payment provisions, while IAS 39 does not require those features.
Future Image—What do we want to look like?

by Mike Kaster, FSA, SOA staff leader for strategic planning

Remember “About Schmidt?” The reviews were good; Jack Nicholson was nominated for an Academy Award and the actuarial profession was getting some publicity. But was this necessarily a good thing? The image of the profession was described, in the words of one person, as obscure and unimpressive. Is this really the image we want to convey? I think I can speak for most of us in this profession and respond with a resounding “no!”

The image we would like to project in the future can be whatever we want it to be—within limits. Today’s actuaries are more versatile and better educated than ever before. Our skills in risk management are strong and well positioned for the changing economy and environment. However, many of the employers we serve do not seem to see the value we provide. There is an untapped potential that exists in every actuary. But the question is: How do we show the world what we can do?

The Strategic Planning Committee (SPC) of the Board of Governors (BOG) sponsored research last year to help answer this and other relevant questions. The most significant of these questions was, “How should the current value of the actuarial skill set and the actuary be enhanced?” When setting the future direction of the profession, the board considered this question very carefully and tried to determine whether or not the profession as a whole was facing an image issue or a skill deficiency issue. Both elements were examined, and the findings were quite interesting.

Relative to the first element—the image of the profession—we relied on the survey results of employers. This survey was conducted with the help of a consulting firm (Leading Solutions Group) during July and August of 2003. The questions in the survey were designed based on review of prior research efforts and the direction of the SPC leadership. The survey was sent to more than 1,500 individuals in hiring positions and performed online. Results were compiled based on a response rate of 22 percent.

Great care was taken to make sure that all relevant areas of actuarial practice were represented, as well as a key future area of practice—the broader financial services (BFS) sector. This industry sector includes commercial and investment banks, mutual fund providers and other financial services providers. The BFS market was chosen after careful consideration by the SPC of new markets that offered the greatest opportunity for actuaries. There was a consensus among this leadership group that the profession needed to move into some non-traditional fields in order to grow and remain prosperous. BFS was considered the pilot market to test and explore, and seemed to offer the greatest opportunity for the profession.

Some key findings from the survey are presented here. The full report is available at www.soa.org/strategic/strategic_planning.html.

The profession is facing increased competition. Professionals in risk management are gaining in notoriety, including credentialed individuals from GARP and PRMIA. These credentials are gaining in recognition even in our traditional sectors. The more common professionals who compete for roles in risk management are individuals with other credentials, like the CFA certification, as well as individuals with an MBA. When asked whether or not actuaries are facing more competition for roles in their firms, the vast majority of employers indicated that actuaries are facing more competition today than in the past.

Relative to the skills actuaries possess, there are some clear positives that surfaced as a result of the research. People who are members of the actuarial profession are seen as highly capable and intelligent, with a strong sense of professionalism and are also highly regarded for being extremely ethical in their pursuits. Several times over, the survey respondents indicated that the actuarial profession represented an important skill set needed by their firms. When there are questions that require advanced modeling or quantitative analysis, most firms know that they can call on an FSA or ASA.

When we asked employers about actuaries’ ability to contribute to solving business issues, communicating business solutions and showing strong business acumen, the profession didn’t fair as well. (See Figure 1.) This is especially true when compared to the competition.

Figure 2 on page 17 shows 18 different attributes and skills actuaries were rated on and evaluated by employers in our traditional employment areas (insurance, reinsurance and consulting). We also asked these employers to rank the same skills of competing professionals. The scores (on a scale of 0-100) represent the average score across all industry sectors. As you can see, we clearly outrank the competition in the traditional areas of quantitative skills. However, we fall short when it comes to the general business savvy skills. When we talk about the image of the profession, this data shows that the perception of the employers needs to be addressed. But it also indicates that there may be some skill development needed. When we look at these same skills from the perception of actuaries—gained from a similar survey performed with SOA members—the perception is in alignment.

Current Performance of Actuaries

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<th>Employers’ Rating of Actuaries Skills</th>
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<tr>
<td><strong>Highest Performance Rating</strong></td>
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<tr>
<td>Ethical</td>
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<tr>
<td>Quantitative (Modeling)</td>
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<tr>
<td>Solving Complex Problems</td>
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<td>Financial Assessment and Reporting</td>
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<td><strong>Lowest Performance Rating</strong></td>
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<td>Bold, Takes Informed Risks</td>
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<td>Business Communications Skills</td>
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<td>Proactive</td>
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<td>Can Focus on Big Picture</td>
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<td>Business Acumen</td>
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Figure 1
While it is important to know how we currently rank with our employers on these skills, it is also important to know whether or not they feel a need for actuaries to improve these skills. We asked them to rank the relative need for improvement for actuaries. (See Figure 3.) Those areas requiring the most improvement—in the view of these employers—were the same skills that we received a low ranking. So, there is a clear call for the profession to work on improving communication and business skills. Our employers are telling us we need to do this to remain relevant.

While the need to improve these skills has been clearly identified, no conclusions have been drawn on how to accomplish this task. This skills issue will be further examined and explored by the SOA leadership, as debate in this area is considerable. And while it may not be clear that the SOA should deliver training on business acumen skills, it is clear from the surveys that the SOA must assist members in their efforts to develop these skills. This could come in the form of partnerships with other organizations to deliver training in this area. All possibilities will be explored in the future.

Based on this information and review of our member survey, the BOG decided last October to begin plans to invest in an image building campaign for the profession. This campaign will be based on careful review and analysis of the information obtained from these research efforts. The image building initiative will require the support of the entire profession and all the actuarial organizations in North America. During a recent meeting of the presidents of the North American actuarial organizations, these research results were presented. The unanimous conclusion: this issue needs to be addressed NOW.

While we clearly need to begin a campaign to market the actuarial profession and improve our image in the eyes of our publics, there is also a need to build the skills of our membership. The data reviewed by the board indicated that the answer to the question of whether or not we have an image issue or a skill issue was—both! This means that we need to deliver what we promise in our image campaign. We will need spokespersons who can help present the positive images of the profession. The profession is not a weak one. We are working from a position of strength. There has never been a more important time in the history of the profession than right now. We must act to remain vibrant and to thrive.

In the future, actors like Jack Nicholson may be sought to play roles in movies where the character is an actuary. But our hope is that the image of the profession will not be that of a tired professional who comes into retirement realizing that he hasn’t really contributed anything of substance during his career and feeling utterly adrift. Rather, the image might be that of Tom Cruise in “A Few Good Men.” The character he portrays is analytical, proactive, a good speaker and he just wants the truth! The question is: Can we, as a profession, handle the truth? ☛
CE symposium focuses on retirement

It’s not too late to make your reservation to attend the SOA’s Managing Retirement Assets Symposium, scheduled for March 31-April 2, 2004 at the Flamingo Hilton in Las Vegas, NV.

“The emphasis in retirement planning has been heavily on accumulating assets for retirement, and not on how they will be distributed,” said Anna Rappaport, Mercer Human Resource Consulting, Chicago, who will be delivering the opening remarks for the symposium. “The big issue of the next decades is balancing asset accumulation with distribution and improving risk management in retirement. It is important for those advising retirement plan sponsors, retirees and organizations offering products for risk management to mutually understand the risks and what can be done to manage them.”

To that end, the symposium will present papers on subjects ranging from “Risk Pooling Strategies” to “Plan Sponsor Considerations,” as well as examining the impact of long term care options.

“What’s really great about this symposium—aside from the fact that we are again proud to be offering cutting-edge content to the actuarial profession—is the really great group of organizations we are working in conjunction with, including AARP, Gerontological Society of America, LIMRA, LOMRA, NASI and the Pension Research Council, to name just a few,” said John Riley, the SOA’s managing director of continuing education.

Attrition clauses ensure hotels will realize their profit, even if rooms sit empty.

The Society of Actuaries incurred attrition charges from the 2003 Spring Meetings in part because attendees chose to stay in rooms outside the contracted hotel. Also, some attendees stayed at the contracted hotel, but they booked their rooms outside of our block. When attendees circumvent the process of making room reservations established by the SOA, the SOA has a hard time defining the value of the business, and in turn runs the risk of losing negotiating power with the hotel. The hotels contract room blocks and meeting space with their clients based on the history of previous meetings. Without an accurate history we forfeit the ability to negotiate and block the necessary number of hotel rooms needed for the group. If this happens, the SOA will be forced to contract smaller room blocks and will have to pay a premium for meeting room rental. Should we continue to pay attrition and/or meeting room rental, the SOA may be forced to increase registration fees to cover these expenses.

Attrition has become an epidemic not only for the Society of Actuaries but also for the entire meetings and convention industry. We all know there are many different avenues of booking a hotel room as well as many different properties that you can choose from. Many hotels place lower rates on the Web because they have a strong incentive to price the room to sell. Much like the airline industry, the seat on the plane and the bed in the hotel are perishable. If an airline seat or a room goes unsold, that revenue is lost forever.

Wanting to save money on a hotel room is certainly understandable. However, it is also important to look at the big picture. When attending SOA events, we encourage you to stay at the contracted hotel to maximize the quality of your meeting experience and to assist the SOA in achieving its room block commitment. We will continue to do our best to negotiate the lowest possible rates and to provide you with quality programs!

Hotel attrition: An epidemic

by Colleen Fiore, CMP, director of meeting services

How many meetings does the Society of Actuaries plan in a given year? Maybe 50? Perhaps 100? Wrong! The SOA contracts over 150 meetings a year with various hotels and conference centers.

When an association books a meeting at a hotel, the room rate is negotiated based on the history of previous meetings, as well as the room block and the amount of food and beverage consumption that the association has agreed to guarantee. In exchange for this business, the hotel provides services such as front desk staff, meeting room set-up, housekeeping, concierge, etc. When the association neglects to fill its room block, the hotel bills the association for lost guest room profit. This is called attrition.

In addition to the Managing Retirement Assets Symposium, attendees can also take advantage of the opportunity to attend exhibits and sessions at the Annuity and Pension Conference, running concurrently at the Flamingo. As well, there will be numerous networking opportunities for attendees to meet with colleagues and symposium participants.

“It is certainly shaping up to be a very well-rounded event,” added Riley. “We have included useful content, combined with ample extras—such as keynote addresses and continental breakfasts—to serve as good networking opportunities. I think everyone who attends will be very pleased.”

For more information on the Managing Retirement Assets Symposium, visit the SOA’s Web site at www.soa.org or contact John Riley via phone at 847.706.3542 or e-mail at jriley@soa.org.
Apply now for the John E. O’Connor, Jr. Scholarship

Established in honor of John O’Connor who served as executive director of the Society of Actuaries for 20 years, The Actuarial Foundation will provide a limited number of scholarship awards of $2,500 (U.S.) to recognize and encourage academic achievement of graduating high school seniors pursuing a higher education in the field of mathematics. This scholarship has been made available through a donor advised fund for citizens of the United States or Canada.

The deadline for applications is Thursday, April 15, 2004. Winners will be notified on Monday, May 17, 2004.

The application and procedures may be found on The Actuarial Foundation’s Web site at: www.actuarialfoundation.org.

Research Conference

Applied Actuarial Research Conference takes place March 8-9, 2004

The SOA’s Committee on Knowledge Extension Research and the Committee on Finance Research are two of the many sponsors of the University of Central Florida’s Applied Actuarial Research Conference to be held March 8-9, 2004 in Orlando, Fla. This event is an opportunity for actuarial practitioners and academics to identify research needs and exchange ideas about the applicability of the latest actuarial research. Those interested in attending should visit the conference Web site at http://www.cas.ucf.edu/statistics/AARC2004.htm.

More information about suggested topics and critical deadlines are shown in the Call For Papers posted on the SOA Web site: http://www.soa.org/research/index.asp. Abstracts must be submitted by March 1, 2004.

Papers that were presented at the successful 2002 “Living to 100 and Beyond: Survival at Advanced Ages Symposium” can also be found on the SOA Web site: http://www.soa.org/research/living.html.

Research Conference

New study explores decisions facing married retirees

The Urban Institute has concluded a study examining the decisions facing married retirees on pension benefit payout options and the factors that influence their choices. The final report, “Single Life vs. Joint and Survivor Pension Payout Options: How Do Married Retirees Choose?” investigates the costs and benefits that married retirees consider when choosing either a single life annuity or a joint and survivor annuity. In addition, the report considers retirees with defined benefit (DB) coverage who choose a lump sum distribution and examines the factors influencing this decision. The study was co-sponsored by the Actuarial Foundation and the SOA’s Retirement System Practice Area and Pension Section.


Life

Call For Papers: “Living To 100 and Beyond” deadline is March 1, 2004

The SOA’s Committee on Life Insurance Research is organizing the next “Living To 100 And Beyond: Survival at Advanced Ages Symposium,” slated for January 12-14, 2005 in Orlando, Fla.

This international symposium, which includes the contributions of many participating organizations, will focus on survival rates at advanced ages and the implications of lengthening lifetimes, bringing together actuaries, demographers, gerontologists and others to share their knowledge and ideas.

A Call For Papers has been issued and includes the following topics:

1. Implications of an aging population for social, financial, health care and retirement systems and/or the impact on quality of life issues.
2. Statistical techniques for the modeling, projecting and analysis of advanced-age mortality data.
3. Theoretical and practical models of advanced-age mortality data.
4. Evaluation of existing data sources.

Authors of selected papers will be asked to present at the event.

More information about suggested topics and critical deadlines are shown in the Call For Papers posted on the SOA Web site: http://www.soa.org/research/index.asp. Abstracts must be submitted by March 1, 2004.

Papers that were presented at the successful 2002 “Living to 100 and Beyond: Survival at Advanced Ages Symposium” can also be found on the SOA Web site: http://www.soa.org/research/living.html.
Puzzles 57 and 58...
Congratulations to solvers and winners!

Kudos to all solvers and winners of Puzzles 57 and 58. Look for a new puzzle in the March issue!

Puzzle #57 September Solution:

1) 5 bottles at $20 each, 6 bottles at $30 each, 7 bottles at $42 each or
2) 4 bottles at $8 each, 6 bottles at $36 each, 8 bottles at $24 each or
3) 4 bottles at $4 each, 6 bottles at $48 each, 8 bottles at $16 each or
4) 5 bottles at $5 each, 6 bottles at $42 each, 7 bottles at $21 each


Congratulations to Chitra Lele and Ashwin Honkan, the September winners of a Famous Solver of ActuPuzzles mugs.

Puzzle #58 October Solution:

shilling, queued, espousal, spider, scold, piecemeal, departs, fanatic, neutral, nature, rehearsal, minks, tonsil, schedule, saying, marshall, stems, impromptu, launder, NAACP, umpteen, undue derelicts, elfin, dendrites, sells, tarantula, realign, tempers, hunky, lycra, steel


Congratulations to Rich Harder, the October winner of a Famous Solver of ActuPuzzles mug!

Notice: Voting begins in March

Voting for the candidates on the first ballot for the 2004 Society of Actuaries election of officers and board members will be held electronically for all Fellows who have e-mail addresses on the SOA database.

To make certain the SOA has your updated e-mail address, please check your information on the online directory at www.soa.org. Voters will be able to download and print the biographical materials and a sample ballot. First ballot voting will begin in March.

Fellows who do not have an e-mail address on the SOA database will receive paper election materials in the mail. Voters will have 30 days to cast their ballots.

For technical questions related to electronic voting, please e-mail Margaret Ann Jordan at elections@soa.org.

For general questions about the first ballot election, please contact Cheryl Enderlein at the SOA office—phone: 847.706.3511; e-mail: cenderlein@soa.org.