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## ACTUARIAL STANDARDS

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- History and development
- Standards affecting insurance company actuaries and consultants
- Value and impact of standards on different aspects of the actuary's work
- Areas where additional standards are needed

MR. GARY CORBETT: I'm Gary Corbett, Senior Vice President and Chief Actuary of The Equitable and a member of the Actuarial Standards Board (ASB). Jack Turnquist is vice chairman of the ASB. He's a consultant with Totidem Verbis in Dallas, specializing in life and health insurance, particularly appraisals and financial reporting. Paul Kolkman is vice president for finance of IDS Life, and he's a member of the Life Operating Committee of the ASB. Dave Levene is senior vice president and chief actuary of the Metropolitan Life, and Walt Rugland is a consultant with Milliman & Robertson in Hartford. Walt has been active in the valuation actuary movement and many other areas involving life insurance companies.

The format we're going to use is that first Jack will discuss the history of standard setting, how it emerged in this country, how the ASB operates, and how standards are developed. Paul will then review those standards that are of specific importance to insurance company actuaries and to consultants working for and with insurance companies. Finally, Dave and Walt will comment from an insurance company point of view and a consulting point of view on the standards that have been developed to date. Are they valuable? How could they be improved? Are there areas where additional standards are necessary? I've encouraged them to be critical.

The ASB is still in its early days. We recognize there are things that we could probably do better, and it's important for us to hear from all the members of the profession as to how they regard the work we've done so far and their suggestions for changes and improvements. I would urge any of you who have comments about standards -- at any time, and not just in response to exposure drafts -- to let the ASB know of your reactions to what we're doing.

MR. JACK M. TURNQUIST:  
**DEVELOPMENT**

Standards of practice have existed in some form from the very early days of the actuarial profession in the United States. These usually appeared in the literature, but were not explicitly written or codified.

They were touched on in some areas in the earlier Guides to Professional Conduct, especially the *Interpretative Opinions*. For instance, in the early 1980s, *Opinion A-4* dealt with Actuarial Principles and Practices for Pension Plans.

## PANEL DISCUSSION

The Academy was the first to respond to specific needs in certain practice areas in the early 1970s by assigning committees to develop recommendations and, subsequently, Interpretations to deal with current problems. These Recommendations and Interpretations were the R and I, which together with G and O from Guides and Opinions, formed the famous, or infamous, body of standards referred to as GORI.

The initial Recommendations and Interpretations developed covered:

- o GAAP for Stock Life Insurance Companies, developed in 1973 by the Committee on Life Insurance Financial Reporting Principles (COLIFRP) in response to the AICPA Audit Guide of December 1972.
- o Statutory Actuarial Opinions, developed in 1975 by COLIFRP in response to the NAIC blank requirement.
- o Pension Plan Obligations, developed in 1976 by the Pension Committee, partly in response to the passage of ERISA of 1974.

New Recommendations and Interpretations continued to be developed for specific needs. In the process, a number of problems evolved:

- o They tended to be very limited in scope;
- o They were disparate in format, especially among those for financial reporting, dividends, and pensions;
- o They were reactive rather than proactive;
- o They tended to become outdated;
- o There was no formal process to determine when revisions or deletions were needed;
- o There was no formal process to identify areas where new standards were needed; and
- o There were two levels of standards, Recommendations and Interpretations. While the distinction was not always clear, the Guides to Professional Conduct assigned different weights and degrees of necessity to observe and comply with each.

The genesis of what has been called the "Standards Movement" in the United States actuarial profession began in March 1979 when the Academy established the Committee to Study the Requirements of Professionalism. The charge to this committee was to determine if there was a need to define a set of uniform standards of practice that would govern actuaries working in diverse fields.

In its report in June 1983, the committee endorsed this concept of uniform standards and that of a single coordinated board with the overall responsibility to manage the process. This set the framework for what followed.

## ACTUARIAL STANDARDS

Over a period of years, as the result of the work of the Standards Implementation Committee (SIC), and later the Standards Organizing Committee (SOC), the Interim Actuarial Standards Board (IASB) was established in the fall of 1985. It was intended that the IASB would operate for a period of between 18 months and three years to see if the concepts and operations contemplated would work in actual practice.

The IASB held two organizational meetings late in 1985 and commenced formal operations in January 1986. In rapid order, the IASB:

- o Developed a set of operating procedures;
- o Established operating committees and task forces, many of which were staffed from existing Academy committees;
- o Identified areas where standards were needed;
- o Oversaw the development, exposure, and subsequent adoption and distribution of new standards;
- o Developed the basic uniform format for actuarial standards of practice to be used for all disciplines and subjects;
- o Developed budgets; and
- o Recruited staff.

The IASB also identified two basic problems. The first was that standards of practice need to be built on principles of actuarial science. In turn, principles of actuarial science develop from the basic foundations or fundamental concepts of actuarial science which are applicable to the profession as a whole. Unfortunately, neither the principles nor the basic foundations of actuarial science had been codified at this time. The need for both was obvious.

The IASB also felt that it would be difficult to present standards of practice in a vacuum, especially if they were to be meaningful to the younger members of the profession. There existed a need for an exposition of the nature of the actuarial profession, its foundations, and the role that standards of practice play – some type of structural framework to accompany the presentation of standards.

As a result, the IASB commissioned two documents. The first was the Trowbridge monograph on *Fundamental Concepts of Actuarial Science*. This was funded through the AERF and published in 1989. Jim Hickman, a member of the IASB, provided the basic outline of topics, which included such basic actuarial fundamentals as random variables, the time value of money, and individual and collective models.

The second document was the "Preface to Actuarial Standards of Practice" developed by Ed Lew. This was funded through the Academy and published in 1989. It is now in the front of the ASB Standards Manual. I am sure you have all read this document. It provides an excellent background and framework for the standards and their role in the actuarial profession.

## PANEL DISCUSSION

The creation of the IASB was also instrumental in initiating the codification of actuarial principles by both the Casualty Actuarial Society (CAS) and the Society of Actuaries (SOA). The distinction between and responsibility for actuarial principles and actuarial practices had been established. The learned bodies, the CAS and the SOA, were responsible for codifying actuarial principles. The Academy, through the ASB, was responsible for codifying actuarial standards of practice. The actuarial organizations became more careful in distinguishing between these terms, which had often been used somewhat interchangeably.

The operations of the IASB were reviewed in detail and evaluated by the SOC, as was its charge from the Academy. At the end of 1987, after 22 months of operations and after extensive discussions with the IASB, the SOC made its recommendations to the Academy that a permanent ASB be established, with a proposed timetable leading to its creation in mid-1988. The SOC also outlined how it should be done, including the structure, funding, authority, autonomy, controls, method of election of board members, their terms, etc. The ASB would be established as a "Section" within the Academy, requiring a bylaws amendment and a vote of the membership.

The bylaws amendment was voted by the membership of the Academy in the spring of 1988 and the ASB was created, effective July 1, 1988. The ASB got off to a running start as a result of the structure and framework development provided by the IASB and the SOC. The procedure provided a smooth transition with no break in continuity.

### CURRENT OPERATIONS

While the ASB was established "within" the Academy and looks to it for funding, there are several unique features designed to assure that:

- o The ASB retains a degree of independence from the Academy and the other actuarial bodies;
- o The ASB receives input by, and representation of, the various actuarial bodies; and
- o The profession was not creating a monster that might get out of hand.

The features relative to independence are:

- o The ASB essentially determines its own budget.
- o The ASB has sole authority and discretion in promulgating actuarial standards of practice.
- o The ASB does not report to or answer to the Board of the Academy or any other actuarial body. The Academy membership created the ASB by a bylaws amendment, and the only way to get rid of it is by another bylaws amendment. Consequently, the ASB is, in reality, responsible directly to the membership.

## ACTUARIAL STANDARDS

The features relative to representation and control are:

- o The presidents and presidents-elect of the principal U.S. actuarial bodies constitute the selection committee which elects the members of the ASB.
- o Limitations are placed on the terms and the succession of terms of board membership.
- o The funding procedure is overseen without funding, the ASB could not continue to operate.

The purpose of the ASB, as set forth in its creation, is fairly simple and essentially threefold:

1. To direct and manage development of standards of practice in all areas of actuarial practice.
2. To expose and promulgate such standards.
3. To provide continuous review of existing standards for needed updating or elimination.

The ASB is composed of nine members, appointed for three-year terms with a maximum of two successive terms. The terms are staggered so that essentially one-third of the Board positions are up for appointment each year. This provides the desired balance between turnover and continuity.

The ASB appointees tend to be senior actuaries with broad-based experience, both professionally and as operating and practicing actuaries. They are generally representative of the areas of practice and types of employment within the profession. For example, the current ASB composition by area of practice is three life insurance, two casualty insurance, two pension, one health insurance, and one academic. By employment background, the composition is three company, five consulting, and one academic. Six members have served as president of one of the principal U.S. actuarial organizations.

As an interesting aside, there is no requirement that an appointee be a member of the Academy or, for that matter, even an actuary. I do not believe there is any immediate intention to add a nonactuary to the ASB, but that latitude exists for future appointments.

The selection committee picks the chairperson of the ASB to serve a one-year term, with a maximum of two successive terms. The chairperson, in turn, nominates two vice-chairpersons, one to function as a deputy chairperson and the other as the chief financial officer of the ASB.

The actual standards of practice are developed by or through the operating committees and task forces of the ASB. There are currently six operating committees covering five practice areas and a crossdiscipline catchall. These are casualty, health, life, pension, retiree health care, and specialty.

## PANEL DISCUSSION

Currently there are also two operating task forces that have been created to develop specific standards of practice. One is the Task Force on Insurance Company Appraisals and the other is the Task Force on Long-Term Care.

In addition, there is an Editorial Advisory Committee. This committee was created to assist the operating committees and the Standards Editor on format and style issues. It also undertakes special projects for the ASB, such as assisting with the development of the Standards Manual and the compilation of the Glossary.

The chairpersons of each operating committee are nominated by the ASB chairperson each year and are subject to approval by the ASB. Members of the operating committees are appointed by the committee chairpersons, subject to ASB approval. As with the ASB itself, the members of the operating committees and task forces need not be members of the Academy, or even actuaries. In the case of the Task Force on Actuarial Appraisals, two of the members are investment bankers.

The organization and composition of the operating committees vary significantly. They range from large and highly structured committees with a number of sub-committees, such as those for casualty and health, to relatively small committees, operating primarily through other committees or appointed task forces, such as those for life and specialty.

The priorities of each operating committee and task force are established by the committee chairperson meeting with the ASB for those standards to be developed or revised within that practice area. This usually is done at the January ASB meeting for the ensuing year. The priorities are updated and modified during the year as needs change and circumstances evolve.

I would like to cover briefly the process of development of standards. The operating committee or task force, usually the chairperson, and, if appropriate, the representative of the committee or group actually responsible for the drafting, present the draft standard to the ASB with a request for exposure. This requires approval by a majority of the operating committee. The draft is circulated to the ASB well in advance of the meeting to allow sufficient time for review. A legal opinion must be provided that the draft standard is in compliance with applicable laws and regulations.

The ASB may either send the standard back to the committee for change with appropriate comments or directions, or approve it for exposure, usually with minor modifications subject to committee approval.

I believe you are all familiar with the exposure and comment procedure. The revised standard, reflecting the comments received during exposure, is then submitted to the ASB, together with a transmittal memorandum, legal opinion, and other supporting material, with a request for adoption or reexposure. This procedure is similar to that for initial exposure. A request for adoption requires a two-thirds vote of the Operating Committee.

The ASB may approve the standard for adoption, usually with minor modifications subject to committee approval, or return it to the operating committee for revision with appropriate directions and comments.

## ACTUARIAL STANDARDS

By this time, you are all familiar with the format adopted by the ASB for Actuarial Standards of Practice. There are a couple of points which do bear additional comment.

The IASB inherited the 13 old Recommendations and Interpretations from the Academy. As noted previously, these were in various formats, styles, and degrees of current applicability. Nonetheless, they remained as Actuarial Standards of Practice. The operating committees, the Standards Editor, and the Editorial Advisory Committee have been involved in reviewing, revising, updating, reformatting, dropping, replacing, combining, and, where appropriate, reexposing these old standards. This has been a long and involved process, and it is hoped that it will be completed by the end of 1991.

The ASB recognized that some actuarial work is done in response to controlling regulatory bodies or other professional organizations that have established rules or requirements that are not in accordance with generally accepted actuarial principles and practices or that prevent an actuary from applying professional judgment. An example would be FASB, which has a somewhat negative attitude as to the exercise of professional judgment in developing values for financial reporting purposes, tending to favor rules or cookbook approaches for consistency and to minimize possible abuses. This caused many problems and much grief with the proposed standard exposed by the IASB on SFAS 87. This ultimately led to the development of a parallel formatted document called an Actuarial Compliance Guideline, which was adopted for SFAS 88.

The format for Actuarial Standards of Practice is not regarded as fixed. Rather, it is subject to modification in special circumstances and as needs arise.

The ASB has scheduled quarterly two-day meetings in January, April, July, and October. Starting in 1991, the meetings alternate between Washington, D.C. and Dallas. The ASB may schedule additional meetings as needs arise. The meetings of the ASB and the operating committees are open to both the membership and the public at large. However, participation in such meetings usually requires a prior request and approval.

*In closing, I would like to emphasize that, in developing standards, the ASB has four principal objectives:*

1. To be proactive rather than reactive.
2. To monitor continually the needs of practicing actuaries and the publics that they serve.
3. Standards should not preclude the exercise of professional judgment by the actuary.
4. To have standards apply as broadly as possible across the various actuarial disciplines.

## PANEL DISCUSSION

MR. PAUL F. KOLKMAN: Before I start through an overview of the standards that have been adopted so far, I want to give a bit of background as to where and how standards fit into the hierarchy of Academy guidance on professional matters. The Academy recognizes standards in three distinct areas which are outlined in the *Yearbook*. The areas are professional ethics, qualifications, and quality of work.

The area of professional ethics is covered by the Academy's Guides to Professional Conduct and Interpretative Opinions as to the Guides, which are also in the *Yearbook*. These cover such generic matters as respecting confidentiality, avoiding conflicts of interest or at least making all parties aware of conflicts if they arise, and not doing anything that is contrary to public policy or the law. These are general, high level, professional standards that pretty much any profession could have, and violation of these then triggers the Academy's disciplinary procedures.

The area of qualification standards is somewhat newer and deals with the formal qualifications to do work in certain areas. It mainly applies to statutory statements of opinions.

The area of quality of work is covered by the actuarial standards of practice which come out of the ASB. These are the uniquely actuarial standards, dealing with the "how to" and the quality of actuarial practice.

The relevance of actuarial standards stems from the Guides and Interpretative Opinions as to Professional Conduct, and primarily, Interpretative Opinion 4, which quotes Guide 4 as saying that the actuary is required to exercise due diligence to ensure that the methods employed are consistent with sound actuarial principles and practices. Interpretative Opinion 4 states that sound actuarial principles and practices constitute Generally Accepted Actuarial Principles and Practices, and then goes on to state that Generally Accepted Actuarial Principles and Practices include Actuarial Standards and Compliance Guidelines. So, actuarial standards are cited in Interpretative Opinion 4, and again, violation of these would then trip the Academy's disciplinary procedures. Opinion 4 goes on to state that an actuary who chooses practices that differ from any standard should be fully prepared to explain what he or she did in that particular case.

While on the subject of Interpretative Opinions, I'd like to cover one more, and that's Opinion 3. Opinion 3 doesn't refer to standards of practice, but many of the standards of practice refer to it. It deals with professional communications by actuaries, not only written communications, but also oral communications.

Interpretative Opinion 3 recognizes four separate types of communications: statements of actuarial opinion, actuarial reports, statements of actuarial review, and required actuarial documents. A statement of actuarial opinion is the formal statement of opinion we make in statutory annual statements. There are obviously other examples, but that's the most common. An actuarial report is any formal written report or oral presentation that serves to convey an actuary's conclusions or recommendations. A statement of actuarial review is a formal statement issued by one actuary who reviews the work of another actuary. A required actuarial document is a document which is prepared by an actuary, but the form and content is prescribed by either law or regulation.

## ACTUARIAL STANDARDS

I'd like to make a couple of other points about Interpretative Opinion 3. It talks about reliance on others -- both actuaries and nonactuaries would be significant here -- and some of the standards address this issue. It also distinguishes between direct and indirect users of actuarial communications. A direct user would be an employer or someone who has retained the actuary. Direct users get to pick the actuary. They've got direct communication with the actuary, usually during the course of the work but certainly when reviewing the final work product. An indirect user is someone who comes across actuarial work later. Indirect users may not have direct access to the actuary; therefore the actuary, in preparing his work, has to be sensitive to the potential for misquotes and misinterpretations.

Moving now to the standards themselves, the typical standard has six parts: (1) purpose and scope; (2) definitions of the terms used in the standard; (3) a discussion of background and historical issues; (4) a discussion of current practices and possible alternatives; (5) an analysis of the issues and specific recommendations; and (6) *communications and disclosures*.

Section 5 is always the heart of a standard; it often has many recommended practices, depending on the particular standard. I won't cover much Section 5 material because it would just take too long. I will talk mainly about Section 1, the purpose of the various standards and their scope, and Section 6, the communication and disclosure requirements. But I will make a few comments on the Section 5 things to the extent they can be summarized and they're interesting or significant.

There are 17 standards, numbered in the order of adoption. Of the 17, nine have significant application to actuaries working either as employees of or as consultants to life insurance companies. The first standard I'll cover is No. 7, dealing with how to do cash-flow testing.

Actuarial Standard No. 7 deals with how to do cash-flow testing for life insurance companies. It doesn't tell you when to do cash-flow testing, but does recommend preparing a report if you perform cash-flow testing as part of your work. It doesn't require a report, but it lists the specific items that should be covered if you do a report. It explicitly allows for reliance on others and, in particular, on investment professionals, recognizing the fact that not all actuaries are expert in such matters.

Actuarial Standard No. 14 is also a cash-flow testing standard. It's a "when to" standard. We have a standard on "how to" and a standard on "when to." No. 14 gives guidance to the actuary in deciding whether or not to do cash-flow testing. It lists areas in which cash-flow testing should be considered, such as pricing and product development, evaluation of alternative investment strategies, and testing of possible repricing mechanisms for nonguaranteed elements, and even the testing of various dividend scales. It also talks about valuation, statements of valuation opinion, and appraisals as being other areas in which cash-flow testing may be appropriate.

As far as an actuarial report is concerned, No. 14 says that if you do a report in any area in which cash-flow testing might be expected -- for example, investment strategies, valuations, or appraisals -- then in your report you need to say whether or not you did cash-flow testing, and if not, why not.

## PANEL DISCUSSION

We now move from the cash-flow standards to Standard No. 10, dealing with GAAP accounting by stock life insurance companies. Standard No. 10 was adopted shortly after the adoption of SFAS 97 by the FASB. Standard No. 10 is intended to incorporate the actuarial considerations needed to determine liabilities and deferred acquisition costs (DACs) in conformity with SFAS 97, both for SFAS 97 products and those former SFAS 60 products now accounted for under SFAS 97. It doesn't require a report, but it does say the actuary needs to be able to demonstrate conformity with the standard, and needs to maintain adequate documentation.

No. 11, dealing with the treatment of reinsurance transactions in life insurance company statements, applies to both ceded and assumed reinsurance transactions, in statutory, GAAP, or any other financial statements. This standard states that the actuary needs to observe the law or regulations applicable to the financial statement. If a state or the accounting profession permits certain transactions, it's okay to recognize them, but ultimately the net of all transactions must make suitable provision for all your future obligations. The actuary needs to be prepared to demonstrate conformity with that requirement. The standard also suggests that the actuary may want to perform cash flow testing to confirm sufficiency.

Standard No. 1, dealing with nonguaranteed elements, applies to any nonparticipating contract in which charges or benefits to the customer can vary at the discretion of the company, and covers the actuary's work in the determination of such charges or benefits. A report is required, and the standard lists the items that must be included. It doesn't detail how to set charges or benefits, but does require that whatever is done be documented in a report.

No. 15 is a companion standard to No. 1. It deals with dividends and dividend illustrations on participating business issued by both mutual companies and stock companies. It again describes the basic responsibilities of the actuary in the determination of dividends. The main distinction between this and No. 1 is, of course, that equity is required among policyholders, whereas that's not required in the nonguaranteed element standard. Again, a report is required, and the standard outlines the items that need to be included in any such report.

Standard No. 5 deals with setting health claim liabilities for any purpose whatsoever, be it a financial statement or something else. It applies to both life insurers and noninsured plans, and it outlines the things that the actuary needs to consider doing in setting such claim liabilities.

Standard No. 8 is another health insurance standard, dealing with filings with the various regulatory bodies, primarily state insurance departments. It covers actuaries that prepare and file such statements, and the actuaries for the regulators that review them. The standard states that these are required actuarial documents per Interpretative Opinion 3, and requires that you include in them a statement that the document was prepared as part of a regulatory filing and may not be applicable for any other use.

The last standard I wanted to talk about deals with risk classification. I guess personally I don't believe that equity is an actuarial principle, but many states and regulations require that certain things be equitable; and if an actuary is going to give

## ACTUARIAL STANDARDS

an opinion that something is equitable, there probably should be some professional guidance on how to do that. Standard No. 12 gives guidance on how to determine whether or not a particular risk classification structure is equitable. Again, it refers to Interpretative Opinion 3, indicating what you need to include in your report, and it pays particular attention to indirect users. In the area of what is or is not an equitable risk classification system, the likelihood of indirect users coming across actuarial work is quite high, and you need to be sensitive to the potential for misquotes and misinterpretations.

That's the last of the adopted standards that I want to talk about, but as Jack mentioned, there are the old Financial Reporting Recommendations and Interpretations, and I'd like to just give you a status report on those. These are also standards of practice in the sense that they've been adopted by the Academy and bear about the same significance in the hierarchy of professional guidance, but there's a project underway to put them into the format of the new standards. The project has been underway for a year or so, and will obviously be subject to the decisions of the ASB; but having seen some of the deliberations, I might be able to give you an idea of where the project is going.

The old Recommendation 1 deals with GAAP for stock life insurance companies. Standard No. 10 overrode much of what is in Recommendation 1; there is very little in Recommendation 1 that is really significant anymore. The material that is significant is the SFAS 60 material that wasn't changed or overridden by SFAS 97. The intent is not to come up with a new standard for that, but to go back and enhance Standard No. 10, to include the material from the old Recommendation 1 that is still significant.

A couple of other Recommendations and Interpretations will have the same fate. There is a school of thought that believes that Recommendation 5, on recognition of premiums, would probably be best as a study note. It's really kind of educational and "cookbooky," but there are a few things in there that may be significant, and could wind up in a revised Standard No. 10. Recommendation 6, on participating policies sold by stock companies, was a standard to describe how stock companies should do GAAP accounting for their participating business. Again, the feeling is that this material most suitably belongs in a universal GAAP standard, which is Standard No. 10.

Recommendation 2, on relations with the auditor, was originally written to deal with relations between the actuary working for a stock life insurance company and the external CPA auditor. There's been some discussion about expanding this to an actuarial standard dealing with relations between an actuary, in general, and "regulators" defined broadly; that is, state regulators, external CPAs, the SEC, whoever. There should be a certain professional responsibility in dealing with an auditor reviewing one's work.

It looks like Recommendation 3, on actuarial reports and statements of actuarial opinion, will probably die. This Recommendation has been in place for almost 20 years, and almost no one follows it. It probably doesn't make a lot of sense to have a standard if it's widely ignored. No one follows that standard because it was really there to require the actuary to prepare a report and opinion on GAAP reserves in the

## PANEL DISCUSSION

hope that the accounting profession would respect the report and opinion, as is done in Canada and the U.K.; and that just never occurred.

With respect to Recommendation 9, on materiality, it will simply be redrafted to cover materiality in probably all of its aspects and not just GAAP accounting.

Recommendation 11, on statements of actuarial opinion for interest-indexed universal life insurance, has been a special-purpose Recommendation. It will probably be deleted in the hope that the new statutory statement standard will cover most of what was in here.

And last, with regard to Recommendation 7, on statements of actuarial opinion for insurance company statutory annual statements, the current intent is to reformat Recommendation 7 consistent with the current valuation law. The new standard law involving the valuation actuary concept was adopted in December 1990. States will probably start to adopt it this year. In states that adopt it this year, it will be effective for 1992. The feeling is that we should develop a standard to apply to the existing law, useful for 1991 statements, and then in the interim, prepare one to apply to the new law for those states in which the new law becomes effective in 1992 or later.

MR. CORBETT: I think many life actuaries tend to think these standards apply mostly to consultants and in the pension area, but there is a growing body of standards that do apply to actuaries working for and with life insurance companies.

MR. DAVID LEVENE: When Gary asked me to participate in this panel discussion, I chose to forego my customary train reading of *The Wall Street Journal* and reread the standards instead. Having reread them, I have only compliments for the ASB and its six operating committees.

I think the standards are well-written, comprehensive, and clearly done by experts in their fields. The exposure and review process appears to be fair and well thought out. The standards provide an extensive checklist of items that we should consider in performing the various actuarial functions. The standards should help us maintain a conscientious approach to our professional responsibilities.

In these difficult financial times for the insurance industry, the spotlight will be increasingly focused on the actuarial profession to provide assurances or warning lights -- to insurance companies, the insurance departments, and the public. It's only a matter of time until the actuary will be looked to by the regulators and the public to sign more statements of opinion in additional areas, and therefore, our profession needs the good work of the ASB to continue.

But Gary told me, "Don't come here and just give praise." "Be critical." "Be controversial." So here goes. First, the standards are boring and definitely not first-rate entertainment. So the problem is how to get the membership to read the standards. Certainly the standards are given lots of shelf space in the *Actuarial Update* newsletter and the *ASB BOXSCORE*. They are even in a nice, convenient, three-ring, gray binder. In preparation for this session, I decided to find out how many people at my company, Metropolitan Life, are reading these standards. So I sent a survey around. The comments I got back ranged from "What gray binder?" to comments that the

## ACTUARIAL STANDARDS

standards were "Very helpful, very good, very informative." The Academy might want to take a similar survey of the membership to find out how effectively the standards are being used.

I also think that the ASB could gain greater visibility for the standards if it were to address its attention to those people who can help influence the use of the standards in their insurance organizations and consulting firms. The Academy could use many more sets of hands in publicizing the standards, such as company chief actuaries or the lead partners in consulting firms. I think that these people have to help the ASB spread the word.

Moving on, the actuarial standards are in general rather broad, and I do not recommend that they be made more specific. One of my survey questions to the Metropolitan Life actuaries, was, "Are the standards too general?" More than 90% of the respondents thought the standards were fine as is and should not be made more specific. I am part of that majority, and I would not want to see the standards be more specific. I think the range of opinion in our profession is appropriately diverse, and we should not try to pigeonhole actuaries into a narrow band of practice. I don't think the profession wants to stop its actuaries from having differences of opinion. Group actuarial consultants can continue to argue with insurance company actuaries over premium rates, and actuaries representing unions and actuaries representing management are entitled to disagree. If we all agreed, a lot of the fun, as well as the legitimate professional differences of opinion would be lost, and what's more scary is that actuarial judgment and experience would be devalued.

So, rather than narrowing the standards, I believe that the ASB standards should be a jumping off place for insurance companies or consulting firms to make the standards more specific for their firm's actuaries.

At Metropolitan Life we have begun the process of "Metropolitanizing" the ASB standards. We are developing Metropolitan Actuarial Practice Standards, which we refer to as MAPS.

One of the first areas in which we are producing MAPS is one where no ASB standards currently exist, and that is in the business planning process. I believe that actuaries need to be proactive and involved in the company's planning process. In my company, actuaries in each line of business help develop the financial plan and projections. We feel it is important that actuaries be involved in the planning process, and not be acting simply as scorekeepers.

Anyone familiar with planning and forecasting is aware of the hockey stick phenomenon where results are always projected to improve dramatically in the "out years." Under our MAPS system, we ask Metropolitan Life actuaries to make their projections realistic, and to furnish an actuarial memorandum documenting and supporting the key financial assumptions used in their business plan. If other actuaries agree that the need exists, the ASB might wish to consider developing a standard for the actuary who is involved in the planning process.

Now, I'd like to get a bit controversial, and suggest to the ASB that it consider developing standards for actuarial work on the asset side of the balance sheet. The

## PANEL DISCUSSION

asset side, with its well-publicized problems of junk bonds, real estate and commercial mortgages, needs the attention and skills of the actuary. Asset valuation, asset experience studies, and projections of future asset values are all areas where the actuarial perspective and discipline could be put to good use. I might add that we might not be welcomed by other groups if we did develop standards in those areas, but I do think it's something we should nevertheless seriously consider. Our profession has gotten our "nose" well under the asset "tent" by way of New York Regulation 126 cash-flow testing, and the standards of practice that Paul referred to, No. 7 and No. 14, but if the actuary is to be an effective and knowledgeable spokesman on the financial condition of his company and his industry, he needs to play an even bigger role in understanding the asset values of his company.

I see that the program for this meeting lists several topics on the asset side; there's one topic on commercial mortgages, and another one on real estate. I think this is evidence of the profession's increasing interest in this area. The development of standards of practice for those actuaries involved or soon to be involved on the asset side would in my opinion be very worthwhile, both in helping the actuary to perform his responsibilities, as well as in publicizing the actuarial profession's interest in this critical area.

In summing up, we have an excellent set of standards, but they need to be better communicated and publicized, and using the senior actuary in the firm to carry the ball would help. I don't believe the standards should be more specific. If specificity needs to be developed, I suggest that it be the responsibility of each insurer or consulting firm to tailor its own specifics. I recommend that an ASB standard be developed for the actuary involved in the planning process, and that a standard be developed to help the actuary assess the past, current and projected performance and values of a company's assets.

MR. CORBETT: Thank you Dave, for a well-balanced set of comments. It's exactly the type of input we in the ASB are looking for. Whether or not standards would be appropriate in the planning and asset areas is something we would have to debate, but we should look at it.

MR. WALTER S. RUGLAND: I will make my comments in four different segments. The first segment will consist of my thoughts on the standards and the need to view standards of practice in the full context of professionalism.

The Society, of course, deals in U.S. and Canadian issues, and when we are talking about the ASB we are talking primarily from the U.S. point of view. When we are thinking of ourselves as professionals, we think of the need to do research; apply that research in practice; practice in such a way that the people who use our work can rely on our results -- both in terms of the methodology we use as well as the approach that we take to the necessary assumptions; be continually upgrading and changing our approach, as a result of research and changes in practice; be qualified to do the work that we are doing; and have the profession itself be able to discipline us if we run astray from the norm or the expectation of our clients in terms of their reliance on us.

## ACTUARIAL STANDARDS

I think these are critical issues. Research, practice, reliance, qualification, discipline, and standards of practice are the basis upon which our clients can rely on us.

We've made real progress in the 1980s. The Society of Actuaries and the Casualty Actuarial Society have undertaken substantial efforts in research; and we are, in fact, beginning to realize the results of those efforts with meaningful work in both the theoretical and practice realms. Our practice areas are developing faster than ever, and we are developing with an unprecedented confidence that we're able to deliver. I think this is true both inside companies and in consulting.

There is a demand from the public, from the people that use our skills, that they be able to rely on us. And they want us to give evidence that they can rely on us. This is a demand for professionalism, which gets back to what professionalism is from research to discipline.

We've advanced in understandable and manageable form the notion of qualification standards in the United States, and we've put in place a system, a process, of developing them that individuals practicing can rely on. We are also close to having a discipline process which might work, which is the concept of the Actuarial Board for Counseling and Discipline. So, real progress has been made. Standards of practice are the critical link in the chain with respect to having our profession meet the expectations of the public regarding professionalism.

The second point I'd like to talk about is what I call the cookbook issue. I was a part of many of the discussions with respect to the ASB. About every third meeting we'd spend half a day on the cookbook issue, and in presentations in the middle 1980s, which are well-recorded in the literature of our profession, there was talk about the cookbook issue.

Back then, the activists for standards were urging us to develop rules that would police those actuaries who practiced in a deficient manner. The people who were observing us and looking at us as a fledgling profession, wanted to rely on us. But they wanted to rely on us in terms that they would define for us and definitions that they would give us. The way they would do it was by telling us to develop standards that were detailed and that they would have a chance to provide input for. So, the activists wanted us to have lengthy standards that took care of the deficient practitioners and observers. They wanted standards which reflected the activists' ideas, methods, and specifications.

The passivists during that time basically said, "Leave me alone, thank you, I'm doing all right, I'll do it my way, and I don't need your advice. Actuarial science is an art, not a science, and rules will stifle my ability to practice, develop my practice, and satisfy my clients." Those passivists were given assurances over and over again that we were in fact not defining practice, but codifying practice.

We were trying to address the twofold question: (1) How can the public rely on the work you do? (2) How can you feel confidence that the work you do is in fact appropriate? We still address this. The ASB approach is not to define a practice, not to create a limit, but to define what is inside a black box for an actuary acting in an area that is a black box. If you choose to operate in a way that differs from the ASB

## PANEL DISCUSSION

way, you must disclose what is in your black box and how your methodology affects the results relative to those approaches described by the standard.

I believe that the cookbook issue has been a tough issue for the ASB. Standards have emerged so far as being almost law, and there has been a question as to whether you can, in fact, deviate from standards. It's been pointed out that there is room to deviate as long as you disclose the deviation, and I think that component of the structure needs to be preserved. There will be long discussions over the next few years about how strictly the standards must be complied with, as opposed to letting practitioners do something different, depending on the situation.

Obviously, it's much more comfortable for us as consultants to comply with the standards. However, there seems to be a new cry for cookbook standards, and I think it comes as much from the passivists as it does from the old activists, maybe more so. Now that we've got a standard which is only a sixteenth of an inch thick, or five pages, instead of a half an inch thick, all the passivists are coming out of the woodwork and saying, "You've got only one paragraph here; you didn't tell me what it means. So, why don't you tell me more about what it says?"

What we need to do as practicing actuaries is to say, "I think I understand what the principle is in that paragraph, and now I'm going to apply it to the best of my ability." When I am talking to people, even in companies, who say, "We don't really know how to do this," my advice is: "Do the best you can. Go back to the literature. Go back to the discussion. Go back to the notes, the exposure notes, and the discussion about the exposure draft, and do the best you can. And the next time one of the exposure drafts comes through, read it and comment on it."

And I think that this is what is beginning to happen. I think that individuals and firms are beginning to realize that the time to really make the most of the standards of practice is when they are in development. That's when we should read them and discuss them, and we should know how we are going to implement them before they get promulgated. If we have trouble with what they mean, we should communicate it to the ASB and to the appropriate committee. I'm convinced that the committees do, in fact, react to those types of comments and do try to do the best they can in terms of responding to responsible suggestions and concerns.

The extent to which the ASB creates cookbooks will, in the long run, stifle our ability to act for our clients and for our interested publics. We need to be careful and object to detailed standards, and we need to convince ourselves that we can deal with standards that rely on us to act as professionals.

The third area I'd like to talk about is the value of standards in my work as a consultant. Perhaps it is best to start with the client's point of view. I think the standards provide a lot of help in dealing with my clients. First of all, they give me trappings of a profession, which I didn't have before, and believe it or not, I think that's important. It's an advantage for me to be able to say, "My professional requirements say that this is what I must do"; it was difficult to say that before. Once in a while we'd say, "Our firm requirements say that this is what I must do," and that sometimes carried the day. But if you can basically say that, "You asked me to act for you as a

## ACTUARIAL STANDARDS

professional; my profession has defined that this particular assignment needs to be done this way," you don't have to defend the approach you're taking.

People want to rely on us for our work, and now we can better deliver on their expectations. They want a basis on which to rely on us, and now we can give them that basis, by saying that we have complied with the standards of practice of our profession.

We are getting into situations that require professional opinions and comments. The Academy legal counsel was asked to make a list of all the types of opinions that are required in statutory law and regulations for life insurance companies, and he came up with well over 50 opinions. We're not going to be able to deal with all of them with standards. But we have to try to create an environment where professional practice is applied to each one of those situations. To the extent that we can identify a common thread in those requirements for actuarial opinions, we can use standards to help bolster our work.

I think that as we become more adept at developing and implementing standards of practice, we're going to find that all kinds of people will line up and ask us to do work. That may lead to a situation where people try to pass onto us all the problems they can't solve. In one way that's nice. On the other hand, we need to be careful that we don't define our profession ahead of our ability to get at some of these issues. Overall, though, I think we tend to be too bashful about what we can do. I think we should step up and try to use our skills wherever people ask us to use them.

From a consultant's point of view, how do standards affect our work? First of all, I believe they affect the way we organize our work and the process we use as we implement our assignments. They have helped me and my staff focus on our responsibilities and our accountabilities. They have also created ways in which we can communicate better with our clients, because they add another dimension -- how we are complying with the standards of practice. They also assist us in focusing our discussions; we have found in a few instances that discussing exposed standards has been beneficial, both internally and with clients. So, we're going to spend more time within our firm talking about standards in the exposure process, and without stifling individual comments, attempt to comment on them as a group. I'd be interested as we go forward, Gary, in seeing if you're finding more and more comments on exposures from groups of actuaries, either within companies or within consulting firms.

The standards as they are promulgated provide us with an established "standard of care." I guess that goes back to the medical profession where you can say what the established standard of care is for a particular assignment. The standards tell us what we should do with respect to an assignment. The whole notion, though, is also a mind-set-changing process. As we establish a standard of care in defined areas, we will find, I believe -- and I think we're already doing this -- that our mind-sets change as we move into nondefined areas, or defined areas not touched by the standards. We will find that our ability to think about how we are dealing with the projects in front of us has been expanded.

## PANEL DISCUSSION

In our firm's consulting practice of life and health insurance, we want to have all of our actuaries comply with the standards of the ASB, and we supplement those standards with additional internal standards of practice that we think are appropriate. Our internal standards tend to be more "cookbook," which is appropriate because they deal with our internal issues.

In the fourth segment of my comments I'd just like to address some random ideas.

It's important for all of us to remember that there is no one on top that's telling the ASB what to do. I hear a lot of people saying, "The Academy Board ought to get after the standards people and get this done." But in fact, there is nobody up on top that can talk to the ASB about getting things done. You and I are the ones that have the most impact on the ASB, and we need to let it know what we think needs to be done. So, it's not only communicating to the ASB with respect to exposures that's important; but it's also communicating to the ASB with respect to issues you think it should address.

With respect to what standards are needed for actuaries practicing in the life insurance area -- I think that we need standard work done now to complement the revision of the standard valuation law. I disagree with the position that Paul noted, that of building a standard that just gets us to where we were. I don't think we need that. The issue with regard to the change in the valuation law is, what does an actuary mean when he or she says that reserves are adequate? It's going to take us more than a year to get that done, and I think we need to start now.

I believe we also need a standard that deals with the actuary's role in measuring performance of a life insurance company and its management. How well is a life insurance company doing? My belief is that statutory accounting doesn't do that. GAAP accounting doesn't do that. Lots of companies are measuring themselves in terms of their performance in different ways, and I'm not sure that the actuaries are being guided well in supporting those efforts. The appraisal standard might be somewhat helpful here, but I think its focus has been on appraisals per se, as opposed to measuring performance.

I suggest that we need to think about a standard for actuaries who are working with insurance company rating agencies. I think that's an area in which the actuaries who work in those agencies need support, and I think it would be appropriate for the ASB to address that question.

To the extent that actuaries are dealing with and taking responsibility for life insurance companies' sales illustrations, the ASB needs to provide guidance. It's questionable whether actuaries will have responsibilities in that area, but if and when they do, guidance is appropriate.

I have another miscellaneous comment. I've been a member of the Practice Council of the American Academy of Actuaries, which is basically a council made up of the chairpersons of various committees that deal with life insurance company issues. One of the discussion points has been whether there should be an Academy effort to ascertain compliance with standards, with respect to specific actuarial functions such as the actuary's statutory opinion.

## ACTUARIAL STANDARDS

The Canadian Institute of Actuaries has undertaken this: A part of the process in doing statutory opinions is to complete a compliance questionnaire, which then gets sent to the professional organization, as opposed to the regulator. So, we may have some open dialogue coming up about the extent to which we should self-police our compliance with actuarial standards. I believe this would be healthy, and that we should proceed with it as fast as we can.

Let me quote something I wrote back in 1984 for a committee report, as a final comment with regard to actuarial practice:

*It's not appropriate for the profession to define exactly what an actuary must do, or restrict the freedom to responsibly choose techniques, applications, procedures or approaches to establishing assumptions according to professional judgment. Rather, it's the goal of the profession to demonstrate to various publics that members of the actuarial profession are accountable for the quality of their work, and that a framework exists to ensure that accountability, and, in addition, to provide a safe harbor for actuaries who practice with due regard to their accountabilities.*

That was the objective of the standards thrust back in the mid-1980s. I think we've come a long way and, in fact, are delivering on that objective now.

MR. CORBETT: Thank you very much, Walter. With Dave's and Walter's examples of critiques and suggestions, I think we should move to getting comments from anybody in the audience who would like to speak about standards, about the ASB, and about the whole process.

MR. SHRIRAM MULGUND: I have two comments. The first one Mr. Levene has already referred to. We as actuaries have spent most of our time on the liability side of the balance sheet. We've got to spend more time on the asset side, and I think the ASB should take a more active role in the valuation of assets, quantification of the default risk, and asset projections. With regard to cash-flow projections and cash-flow mismatch, I think actuaries have concentrated their attention on fixed interest assets, such as bonds and mortgages. But the moment you come to equities and real estate, you have got to bring in some assumptions for the projections. For example, if there had been some guidelines in place for dealing with junk bonds, some of the fiascos that have occurred probably could have been avoided. The actuaries would not have taken into account full credit for the high rates of interest which the junk bonds were providing.

The second comment is that these 17 standards provide guidance to the actuary, but one enhancement that could be considered is providing some practical examples. They could call them guidance notes. For example, in Canada, the Canadian Institute of Actuaries has published some valuation technique papers. They may not all have the force of the recommendations, per se. But they do give some sort of direction or guidance to the actuaries as to how those particular standards could be applied.

Maybe the ASB could consider something like that. It could take some examples and physically go through the process and explain how the particular standard could be

## PANEL DISCUSSION

applied. Of course, there is a danger that some of the actuaries could take that as a safe harbor, but it could be avoided by putting sufficient explanations up-front, and making sure that the actuaries don't use it for the wrong reasons.

MR. CORBETT: There are a lot of things that actuaries might want to be involved with, and if we are involved with them, there should be standards for them. However, if there's no regulatory base for the actuary's involvement, there's no way of assuring that the standards will be used, or that the actuary will even be involved. Assets are certainly not entirely in that situation; for example, one must take into account the cash flow on the assets under New York Regulation 126. So, as David said, there's certainly a large camel's nose under the tent, but it's an area in which I think we want to move cautiously.

Second, on guidance notes, we've had some brief discussion of this. If I remember correctly, this came up at a meeting of the Life Operating Committee. We feel there is a need for more education and illustration as to how to use standards. We're not sure that's something the ASB should be doing as opposed to, say, a practice council in the American Academy or the Committee on Life Insurance Financial Reporting Principles. It seems to us that it's probably better done by them. All of these standards are now incorporated into the study notes. The Society makes a conscious effort to move the standards into the appropriate part of the study notes, but beyond that I think the amplification of the standards would be worthwhile. It's quasi-educational, quasi-standards amplification, that should be taken up by some form of practice council within the Academy rather than the ASB itself.

MR. W. JAMES MACGINNITIE: I chair a new committee of the American Academy on professional responsibility. The charge of this committee is to look at ways to enhance familiarity with the various standards – not only those promulgated by the ASB but also those of conduct and qualification – and familiarity with the discipline process; and also to look at ways to monitor the effectiveness of the various standards. Several speakers have touched on various aspects of the work of this committee. At this juncture, our job is primarily to map out the procedures that the profession might follow, at least in the United States.

One way to show the size of the problem is to point out that the Fellowship Admissions Course, which is now required of all new Fellows of the Society of Actuaries, requires some study in ethics and the various standards that I've mentioned. But we have roughly 10,000 members of the Academy in the United States who are not beneficiaries of going through that Fellowship Admissions Course, and we have some new members coming in every year who will never go through it, such as career Associates and Enrolled Actuaries. So, how do we reach those people? Even for new Fellows, we're reaching them at a very early stage in their professional careers, and the need for continuing education and increased familiarity is also evident.

One of the things that the committee has heard time and again is the widespread belief that standards are for consultants; they don't apply to company people. I attended the Open Forum of the Society of Actuaries for chief actuaries, and I was very pleased to see the great interest that they've exhibited, as was also true in the remarks here. One of the methods that was suggested there by one of the chief actuaries was to, at the point of exposure, make sure that the people who are going

## ACTUARIAL STANDARDS

to be affected become aware of the new standard and how it's going to impact them, and then develop a response to the ASB, if it's an ASB kind of proposal, or to the appropriate Academy committee, if it's that sort of committee. I think that can be a very effective manner of increasing familiarity, and I hope to see its use spread widely.

Finally, I would observe that we're interested in a variety of potential compliance mechanisms, and we are looking with great interest at the Canadian experience with compliance questionnaires for people who are subject to certain kinds of standards. But we are also interested in the sampling of various reports that are filed in the public, and other ways that we might get the policeman out of the station house, which is the description that I would offer of our current discipline process. Certainly, as members of society we don't think that we could maintain law and order if police forces sat in the station house and waited for people to come knocking on the door, and perhaps we have to think about our own professional societies in the same manner.

MR. ALAN W. FINKELSTEIN: I'd like to ask Paul Kolkman a question. In recent months I've seen a lot of group health insurance pricing work that was prepared by brokers, consultants, and underwriting agencies. Products are being introduced so quickly to the marketplace that actuaries don't always have time to do the pricing work themselves. If an actuary is preparing a rate memorandum in accordance with the guidelines of Standard No. 8 and states that he relied on someone else to provide the work, and in fact, does not have access to all the information, what standards exist for stating reliance on others?

MR. KOLKMAN: The reliance guidance is mainly in Opinion 3, and then that's expanded upon in each actuarial standard of practice that refers to it. I'd have to go back and read Standard No. 8 to see what it says about relying on others in a situation like that. I would think that as long as you disclose it, it would be okay, but I'd have to read No. 8.

MR. TURNQUIST: I might add there is one standard that has been approved for exposure which is on data quality, which addresses, among other things, the ability to rely on data. We prohibit blind reliance, but I think this standard will address the issue and certainly affords the opportunity to expand upon it to address any concerns you have.

MR. KOLKMAN: On that issue of getting the policeman out of the station house, I've talked to a couple of people from time to time that have claimed that the ASB seems to be a little schizophrenic. On one side the ASB would like to take current practice as it is today and codify it; but then there's another approach which is that we should set high standards for the profession, and get everybody to read the standards and then live up to them. I think there's a tendency from time to time to bounce between the two.

An interesting situation has come up recently with respect to the statutory reserve opinions filed at year-end 1990. If you read Standard No. 14, there's a very strong implication that you need to disclose in your opinion whether or not you did cash-flow testing, and why -- since, obviously, whether or not you do cash-flow testing on the

## PANEL DISCUSSION

statutory reserve opinion is an open issue, and people talk about it a lot. I know one significant state regulator has gone through the opinions it received in this year, and found that over two-thirds of the opinions filed sort of ignored that. And so then it comes down to, what do you do about standards that set a higher standard of practice but are widely ignored? Do you get into the situation of the old Recommendation 3, where there were one or two people in the country that observed it? It raises a real issue about standards.

MR. RUGLAND: I'd like to make a comment on that. At risk is the ability for us to decide what we do when we do an actuarial valuation. If we're not willing to set the standards and live with them, the standards will be set, and actuaries will not be required to follow them. So, that's what's at risk, and that's why it's so important that, when standards are written with respect to these actuarial functions, we take them seriously, and we comply with them; because the preemption of the standards process will result in regulatory cookbooks or regulatory requirements, which, by and large, do not require professionals after they're established.

MR. THOMAS P. EDWARDS: You had said that you weren't sure that equity was an actuarial concept. I believe it is, and I think the ASB should promulgate a definition of it because I think that, when actuaries talk about equity, we have a meaning that we know, but that people who don't have our background have something totally different in mind if they hear the word equity. I think it would be good to have a definition of the term for our own profession that says, "Here, this is what we mean when we say something is equitable."

MR. TURNQUIST: I think Paul's comment was that he didn't know if the Society had developed a principle on equity, and I think this is one I would like to see addressed by the Society of Actuaries or the Casualty Actuarial Society or in the basic fundamentals.

MR. WARREN R. LUCKNER: I should comment on that, because I am the liaison to the SOA Committee on Actuarial Principles, and the Committee's Fundamental Principles Exposure Draft is being submitted to the Board for approval to distribute. It is a revision of the discussion draft that was distributed about a year ago. The draft does not mention equity directly, but I think it is addressed under the concept of homogeneity of data, and there are some issues related to risk classification that arise in that context.