

## Commentary

# Cookie-Jar Reserves

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With the 2004 Seminar for the Appointed Actuary fast approaching, the Canadian Institute of Actuaries just released the Proceedings from the 2002 seminar. These meetings are for the actuaries who live and breath insurance company financial reporting; the accounting specialist's special meeting.

No doubt many actuaries have their favourite memories of the 2002 seminar but I left with a bad taste in my mouth. On the second day of the conference, I had taken enough emetic:

**Mr. Hawkins:** A second question, more towards Helmut's presentation, was on his term "bulk reserves discretionary by the actuary". Yesterday, we heard, I think, three things that I picked up on. One is inappropriate volatility. Another is that I heard the comment "smoothing"; and I heard another comment yesterday on holding back results. I know that this is all in the public record here. We have recorders, and it will be published. I think that those are quite big statements for the CIA to be presenting to the public. When I did my Fellowship there, I do not remember those things in the standards of practice that I reviewed. Perhaps things have changed, and I have not picked up on that, but I find that fairly disturbing when I hear that so frequently at this meeting. Maybe someone on the practice area or the compliance would like to comment on that.<sup>1</sup>

I'm not sure my grammar was that bad, but that was the gist of my burden. There was no response from persons within the practice area or compliance. All I got was an obligatory "quickie" response from the aforementioned Helmut (being Mr. Helmut Engels, an actuary and Director with the Office of the Superintendent of Financial Institutions). Following that, the chief actuary of Manulife complained about the length of the report he would have to file, allowing the session to move on to other topics, with the session later concluding with the chief actuary of Sun

Life complaining that there were too many things that he must do.

The part of Mr. Engels' presentation that took me over the edge was:

One thing that OSFI is really interested in is any kind of bulk reserves, however they are called, whether they are called cyclical or cookie-jar reserves or special contingency reserves, whatever they are named. If they are at the discretion of the actuary to move up or down, if they are not really based on the calculation of the policy per policy or CALM – grouped basis, we would like to see them disclosed. We are not saying that they are wrong. We are not going to like them, but we would like to see them. We definitely would like to see them tracked from one year to another. Again, that gets back to what John Doran was saying yesterday. One of the worries that we would have is not so much if you have all these bulk reserves, but if something is going wrong in the company and you are drawing down on these reserves and that hides things in your total financials, within the Actuary's Report, we want to see that.<sup>1</sup>

I'm sure a lot of people would want to see that.

Mr. Engels responded to my query with:

**Mr. Engels:** I can make a quickie comment for OSFI. We are not going to second-guess CIA standards or how companies apply them or whether they meet CIA standards. We are of the point of view that we would like to know what is there and how they are being managed and used. Anything that comes into OSFI is very totally confidential. Nothing gets out to the public or analysts or anyone else. We just want to know what is going on.<sup>1</sup>

Wow, that should give a lot of comfort to users of the public financials (it is okay if standards aren't followed,

don't let the public or analysts know what the goings on are, best keep this totally confidential, the public financials are public so they need to be properly managed).

Of course, being fair to Mr. Engels, he is with OSFI and was presenting in that capacity and in this role he may well be indifferent to companies putting aside extra reserves that will enhance solvency (as long as OSFI is allowed to "know what is there and how they are being managed and used"). He is also relieved of conflicts since OSFI no longer has its conflict of sharing actuaries with Canada Revenue Agency (deferring income means less taxes now) and actuaries at OSFI no longer have the professional obligation of addressing non-compliance of standards by other members (an exemption from the actuarial snitch rule).

Further, Mr. Engels was just stating what anyone who wants to know already knows. In 2002 in the face of deteriorating telecom bond holdings, Manulife indicated that it made use of its "rainy day fund" to the tune of \$380 million, allowing its losses from asset write-downs to be offset. As another example, an actuary told me at this 2002 seminar, who was in the

employ of one of the large public companies, that his company held a "John Doe Retained Earnings" reserve (John Doe being a pseudo name, the actual name of the reserve bore the name of the company's chief actuary, until they thought better and gave it a more creative and legitimate sounding name).

The actuarial profession should be concerned with these cookie-jar reserves for the sake of its reputation. The accounting profession, and the auditors within it, should be taking a hard look at their acquiescence with the status quo of actuarial practice. It is surprising in this time of accounting scandals that these professions and the big audit firms are complacent with these accounting practices.

Others may not have been willing to say that cookie-jar reserves are wrong, but I am. Cookie-jar reserves are wrong. Other forms of earnings smoothing and the loose accounting that allows earnings management are also wrong. Maybe it's just me. I guess it is nice to have a cookie jar on a rainy day. □

Note 1: Panel Discussion #8 from 2002 Appointed Actuaries Seminar and is available at [www.actuaries.ca](http://www.actuaries.ca)

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For related articles please see the series of commentaries titled "Flawed Accounting for Life Insurers" and the presentation to the 2004 Annual Meeting of the Canadian Institute of Actuaries, all of which can be found in the publications section of [www.hawkconsult.com](http://www.hawkconsult.com).