MAY 2012

Actuarial UPDATE
THE NEWSMONTHLY OF THE AMERICAN ACADEMY OF ACTUARIES

Academy Weighs In on DB Funding Stabilization

IT SEEMS RETIREMENT SAVINGS are is on everyone's mind these days—and Congress is no exception.

The U.S. Senate recently passed a bill that would alter private-sector, single-employer contributions to defined benefit (DB) pension plans by modifying discount rates.

Now, the pension funding stabilization provision is part of House-Senate negotiations on a long-term transportation bill, which has no shortage of controversy. (The House-passed bill includes language approving the Canada-to-U.S. Keystone XL pipeline, which President Obama has threatened to veto.)

In May 2 letters to each of the House and Senate conferees appointed to negotiate the pension provisions, the Academy's Pension Practice Council suggested that the best way to create stability in pension funding is to smooth contributions directly.

"To the extent the conference committee chooses to include in its conference agreement pension funding changes to create more stability in contributions, the Pension Practice Council believes this could be accomplished better by smoothing outputs rather than inputs," the letter stated.

On the same day the letters were sent, Academy Senior Pension Fellow Don Fuerst met with key Republican and Democratic staff of the four congressional committees of jurisdiction to discuss the measure.

The methodology proposed in the Senate-adopted bill effectively would raise interest rates used to determine plan liabilities by 100 to 150 basis points.

The pension provision was included in the highway bill because it is expected to raise revenue for the federal government—$9.467 billion over 10 years. Allowing employers to base contributions on higher interest rates leads to lower pension obligations and therefore lower contributions, smaller corporate tax deductions, and ultimately more tax revenue for the federal government.

Single-employer DB pension plans use discount rates based on investment-grade corporate bonds to calculate the present value of benefits. A 24-month average currently is permitted for the discount rates. The highway bill provi-

FUNDING STABILIZATION, **PAGE 3**

Check Out the New Academy Website

SAME EXCELLENT CONTENT, a fresh new look, and faster navigation—that's what you'll find on the Academy's new website. While the address is the same—www.actuary.org—the new site gives members, policymakers, media, and the public easy access to the Academy's extensive library of public policy and professionalism content. If you encounter any issues with the new website, please let us know. We welcome your feedback.

What Is Actuarial Soundness?

THE TERMS "ACTUARIALLY SOUND" AND "ACTUARIAL SOUNDNESS" have appeared in state and federal statutes since the early 1900s and have been applied to rates, reserves, funding levels, and solvency. A special report released on May 10 by the Academy's Actuarial Soundness Task Force provides an overview of how these terms have been used historically and how they currently are used throughout the actuarial profession.

"Although we certainly hoped that the terms were not used inconsistently across practice areas," said Actuarial Soundness Task Force Chairperson Shawna Ackerman, "we didn't have a preconceived notion that the historical usage would be in agreement, and our goal was not to develop a common usage."

The report was the culmination of a two-year effort by the task force, which included members from all practice areas. The task force examined how the terms were used in actuarial literature, Actuarial Standards of Practice, National Association of Insurance Commissioners (NAIC) model laws and regulations, and selected state statutes and regulations for the health, life, pension, and property/casualty areas. The biggest challenge, Ackerman said, was the sheer volume of material the task force had to consider. She also said that the NAIC staff provided a good starting point for the research by supplying some of the regulatory sources in which the relevant terms appeared. Once the report was drafted, it was vetted by representatives from each of the practice areas during an extensive peer review process.

The report concluded that while "actuarially sound" is defined specifically in some circumstances, more often it is used as a general term to mean "reasonable and consistent

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CALENDAR

MAY

8 CUSP meeting, Niagara-on-the-Lake, Ontario

9–10 NAAC meeting, Niagara-on-the-Lake, Ontario

17 Academy Board of Directors meeting, Washington

20–23 CAS spring meeting, Phoenix

23–26 IAA meeting, Los Angeles

30–June 1 NAIC Financial Summit, Washington

JUNE

21–22 CIA annual meeting, Toronto

25 Professionalism Webinar (Academy, ASPPA, CAS, CCA, SOA)

JULY

12–15 NCOIL summer meeting, Burlington, Vt.

16 Summer Summit, Washington (Academy)

AUGUST

11–14 NAIC summer meeting, Atlanta

15 Executive Committee meeting, Washington

SEPTEMBER

6–7 Casualty Loss Reserve Seminar (Academy, CAS, CCA)

13 Professionalism webinar: *Precept 13 of the Code* (Academy, ASPPA, CAS, CCA, SOA)

OCTOBER

5–6 NAAC meeting, Mexico City

10 CUSP meeting, Washington

11 Board of Directors meeting, Washington

14–17 SOA meeting, Washington

15 Academy Annual Meeting, Washington

21–24 CCA annual meeting, Baton Raton, Fla.

28–31 ASPPA annual meeting, National Harbor, Md.

NOVEMBER

8–9 Seminar on Effective Loss Reserve Opinions, Baltimore (Academy)

11–14 CAS annual meeting, Lake Buena Vista, Fla.

To continue receiving the *Update* and other Academy publications on time, remember to make sure the Academy has your correct contact information. Academy members can update their member profile at the member log-in page on the Academy website.

Academy NEWS Briefs

Your Voice Counts

THE ACADEMY WANTS TO KNOW what its more than 17,000 members are thinking. To find out, it has contracted with an independent survey research firm specializing in membership organizations to gauge member opinion on a variety of issues, including how well the Academy is accomplishing its mission and the value members place on their Academy membership.

Members will receive an email in June with a link to an online survey. The survey will be brief and take about five minutes to complete. Plan now to give it some serious thought and attention when it arrives. Your opinion counts and will make a difference.

This year's survey is a follow-up to the 2006 Academy survey that gathered members' opinions on brand, image, value, satisfaction, meetings, education, and information. The results from this year's survey will be publicized in the fall and will serve as a guide for Academy leadership in the future.

Rothenberg to Keynote 2012 Annual Meeting

MEMBERS LOOKING for the best intelligence on how the races for the White House, House, and Senate will shake out this fall should plan to attend the Academy's Oct. 15 Annual Meeting and Awards Luncheon and hear keynote speaker Stu Rothenberg.

Rothenberg is the editor of the respected *Rothenberg Political Report*, which has earned a reputation over the years for accurately predicting the final Electoral College vote and the results of each contested Senate and House race. In addition to publishing the semi-monthly *Rothenberg Political Report*, Rothenberg writes a column for Capitol Hill's *Roll Call* and authors op-eds that appear in leading newspapers like *The New York Times*, *The Washington Post*, and *The Wall Street Journal*. Rothenberg also is a frequent guest on PBS *NewsHour*, NBC's *Meet the Press*, ABC's *This Week*, *Nightline*, and *The McLaughlin Group*. Speaking just 20 days before America votes, Rothenberg is sure to provide insights and analysis that will help actuaries track the changing electoral landscape and what it means for the public policy issues on which the Academy engages policymakers and regulators.

This year's meeting is being held in conjunction with the Society of Actuaries Annual Meeting at the Gaylord National Resort in Washington.

A Call for Volunteers

LOOK FOR AN EMAIL in early June with a link to the Annual Volunteer Survey. The online survey is a chance for members to express their interest in taking part in the important work of the Academy. Serving on an Academy committee offers members many benefits—from professional growth and career development to networking with other actuaries and developing relationships with leaders within the profession—all while contributing their time, talent, and expertise to advance the actuarial profession.

SAVE THE DATE!

P/C Effective Loss Reserve Opinion Seminar: Tools for the Appointed Actuary

Nov. 7–8, Baltimore

The seminar sessions on the first day will cover foundational topics, while sessions on the second day will focus on more advanced subjects. Participants may register for either or both days. The seminar is presented annually by the Academy's Committee on Property and Liability Financial Reporting.

PROFESSIONALISM WEBINAR

June 25, Noon–1:30 p.m. EDT

Keep an eye on your inbox for more details about the next Professionalism webinar on the ABCD request-for-guidance process and specific examples from 2011, with ABCD members Curtis Huntington and Kathy Riley.

IN THE NEWS

ACADEMY DEFINES "QUALIFIED ACTUARY" FOR ACA

LifeHealthPro picked up a letter penned by Academy leaders John Morris and Tom Wildsmith to state legislative leaders and insurance commissioners. The letter recommends a uniform definition for "qualified actuary" for state regulations seeking to comply with Affordable Care Act rate-setting provisions.

PENSION PLANS AND BUYOUTS

Senior Academy Fellow Don Fuerst was quoted in a *Pensions & Investments* story on Ford Motor Company's retiree pension buyout and the likelihood that more corporations would do something similar in the future. Pension Practice Council member Ellen Kleinstuber helped *Reuters* explain some of the choices employees of Ford and other companies face when offered a lump-sum pension buyout.

PRINCIPLE-BASED REPORTING

The Academy was cited in *LifeHealthPro* for its work with NAIC's Life Actuarial Task Force in developing a new life reserve standard.

Funding Stabilization, continued from Page 1

sion would introduce a new 25-year average of these rates. The rates actually used in 2012 would have to be within a 10 percent corridor of the 25-year average. Between 2012 and 2015, the 10 percent corridor gradually would expand to a 30 percent variant. The 25-year average is currently significantly higher than the 24-month average, and the applicable rate would be raised to the lower limit of the corridor.

"Higher interest rates mean lower reported liabilities and the appearance of a plan being better funded than under the current rules," said Fuerst. "Lower reported liabilities also mean lower contributions by plan sponsors."

The issues extend beyond minimum funding requirements. The reported liability, called the funding target, is used for several other purposes in the Pension Protection Act, particularly for Section 436 benefit restrictions that apply if a plan's funded ratio falls below 60 percent to 80 percent. Lowering reported liabilities raises funded ratios and makes it easier for plan sponsors to fund plans sufficiently to avoid these restrictions. The council's letter addressed this concern by noting that the thresholds could be lowered temporarily if Congress chose to relax these restrictions.

The outlook for this provision remaining in a final highway bill is unclear, just as the likelihood for an overall agreement remains murky. Given the significant differences between the Senate and the House bills, negotiations are likely to be difficult.

Current congressional authorization of transportation expires on June 30, so conferees are under pressure to produce an agreement before then.

Meet the 2012 Insurance Legends

The Actuarial Foundation presented the 2012 Insurance Legends Award to Frederick J. Sievert and Irwin T. Vanderhoof (in memoriam) at a March ceremony held in conjunction with the 2012 ReFocus Conference in Las Vegas.

The Insurance Legends Award celebrates individuals for their leadership, intellect, and personal achievements, as well as their significant contribution to the insurance community and society in general.

THE ACTUARIAL FOUNDATION®

LIFE AND HEALTH QUALIFICATIONS SEMINAR

Nov. 12–15, Arlington, Va.

The Life and Health Qualifications Seminar offers state- and country-specific basic education that may not have been provided as part of the Society of Actuaries examination process or acquired through subsequent testing or alternative education. It also can serve as a basic education refresher or as a source of continuing education for more experienced actuaries as required under the specific Qualification Standards.

For more information or to register, visit http://www.actuary.org/seminar/2012/index.asp.

AMERICAN ACADEMY of ACTUARIES
Election News

2013 Officer Nominations

THE ACADEMY BOARD OF DIRECTORS will vote on the slate of 2012 officer candidates at its annual meeting, which will be held with its regular fall board meeting on Oct. 11. The Academy's Nominating Committee has recommended to the board a slate of officers led by Tom Terry, president of TTerry Consulting in Chicago and chairperson of the Public Interest Committee, as the candidate for Academy president-elect in 2013.

In a report delivered at the May 17 meeting of the Academy's Board of Directors, the committee also named Art Panighetti, an actuary at Northwestern Mutual in Milwaukee, to serve as the Academy's treasurer and nominated Steve Rosen, senior consultant at Stephen H. Rosen and Associates in Haddonfield, N.J., to serve for a third year as the Academy's secretary. The secretary and treasurer positions are elected annually by the board, with a limit of three consecutive one-year terms. Panighetti previously served on the Academy's board as 2010–2011 vice president for life issues.

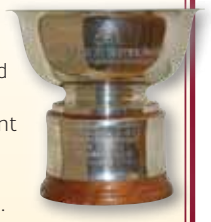
On the slate to fill what will be three open vice president positions on the board are: Mike Angelina, executive director of Academy Risk Management and Insurance at St. Joseph's University in Philadelphia, for casualty; David Shea, an actuary in Richmond, Va., for health; and Karen Terry, assistant vice president and actuary at State Farm Mutual Auto Insurance Co. in Bloomington, Ill., for professionalism. Vice presidents serve a two-year term on the board.

The Nominating Committee will report to the membership on nominees for the three open regular director positions in June, when the candidates will be introduced before the launch of the on-line election in which all members can vote, to be held this year between July 23 and August 17.

The Nominating Committee is chaired by 2010 Academy President Ken Hohman. Members of the committee include Mary Bahna-Nolan, Ralph Blanchard III, Cecil Bykerk, Mary D. Miller, Mary Frances Miller, Jeff Petertil, Adam Reese, Dave Sandberg, Don Segal, and Annie Voldman.

Jarvis Farley Service Award

Nominations Sought



The Jarvis Farley Service Award is presented annually to a member whose efforts on behalf of the Academy have made significant contributions to the advancement of the actuarial profession. Nominations for the 2012 Farley Award are now being accepted.

Eligible candidates are Academy members who have:

- Demonstrated their commitment to professionalism;
- Made extraordinary contributions to the actuarial profession through longtime service as Academy volunteers;
- Been an inspiration to practicing actuaries; and
- Commanded respect inside and outside the profession.

With the exception of previous Farley Award recipients, any Academy member may be nominated. Past Academy presidents may be nominated, but only their post-presidential service will be considered.

For more information or to nominate a candidate, go to http://www.actuary.org/awards/farley.asp. Or contact Kasha Shelton, manager of membership operations, at 202-223-8196 or membership@actuary.org.

Nominations are due by July 6.

Nominations Sought for 2012 Myers Service Award

The Robert J. Myers Public Service Award, named for the former chief actuary of the Social Security Administration, recognizes actuaries with a single noteworthy public service achievement or those who have devoted careers to public service.

Nominees should be members of the Academy who have:

- Demonstrated their commitment to professionalism;
- Made an extraordinary contribution to the public good through service to the government or other organizations in the public sphere, even when facing conflicts from political pressure;
- Been an inspiration to practicing actuaries; and
- Commanded respect within and outside the profession.

For more information or to nominate a candidate, go to http://www.actuary.org/awards/myers.asp

Nominations are due by July 6.

Dadisman Joins Academy Staff

COMMUNICATIONS VETERAN ELLEN DADISMAN has joined the Academy as assistant director of communications for public affairs. She is responsible for informing and driving media coverage of the Academy's work in public policy and professionalism.

Like that of many Washingtonians, Dadisman's career in public policy was launched by a congressional internship. From there she served as deputy press secretary for former Sen. Bob Graham (D-Fla.) and held a number of communications positions in former Florida Gov. Lawton Chiles' administration. As communications director for the U.S. House Committee on Ways and Means, she represented members of Congress as they debated the future of Social Security, Medicare, and other entitlement programs.

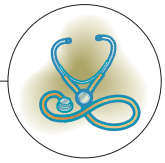
"On the Hill, the Academy is highly regarded among key stakeholders for its expertise and respected for being nonpartisan," Dadisman said. "Preserving and enhancing that reputation will be a priority as we work to expand the footprint of the profession."

In recent years, Dadisman has led communications campaigns that shaped policy debate for two other nonpartisan groups: the Council on Foundations and the Biotechnology Industry Organization.

"The Academy and its members will benefit from Ellen's ability to make the complex work of the profession accessible to broader audiences and to ensure the actuarial voice is heard on important public policy issues, across the spectrum," said Mary Downs, executive director of the Academy. "Health care reform, lifetime income and retirement security, enterprise risk management, and federal oversight of insurance are all receiving a great deal of attention right now, and with Ellen on board we're poised to be part of the dialogue."

Ellen Dadisman is the Academy's new assistant director of communications for public affairs.

A native of Georgia, Dadisman holds a bachelor's degree in American studies from Florida State University. She says she made Washington her home because it has a big-city exuberance while retaining a strong sense of community. She lives near the National Cathedral, and enjoys cooking, gardening, and reading.



LTC Options Outlined

EFFORTS TO FIND SOLUTIONS to long-term care (LTC) for the American people didn't end last fall when the administration decided not to implement the Community Living and Assistance Services and Supports (CLASS) Act. While the design and benefit structure of the CLASS Act were determined to be actuarially unsustainable, the Academy's Federal Long-Term Care Task Force continues to look for solutions to address LTC costs, access, and quality.

In an April 27 letter to the National Conference of Insurance Legislators' LTC and Health Retirement Committee, the task force identified several criteria that should be considered when evaluating LTC programs, including financial soundness and sustainability, the affordability of coverage, eligibility, and the appropriateness of incentives.

There are several ways to reduce consumer and/or state Medicaid program costs related to LTC and LTC insurance while maintaining appropriate benefits, the task force wrote. It outlined several general approaches, including:

- Enabling state Medicaid LTC programs to provide effective care for the indigent population for which Medicaid programs originally were intended by tightening financial eligibility rules and encouraging home health care options for those eligible for Medicaid LTC services.
- Promoting alternative approaches to address LTC risks, such as encouraging limited benefit plans and combination insurance plans and exploring state-based public insurance demonstration programs.
- Encouraging partnership programs by ensuring that eligibility rules are consistent between Medicaid and any other programs that enable combination products to become partnership eligible, and by allowing home health care benefits.
- Supporting the development of private LTC insurance so that more people have affordable options and have access to LTC coverage that has shorter benefit periods, longer elimination periods, and last-survivor benefits. Allowing LTC insurance to be purchased with pre-tax funds and modifying the requirements for inflation protection also would encourage the development of private LTC insurance.

Work Group Comments on MLR Reporting Form

AS PART OF THE AFFORDABLE CARE ACT, insurers are now required to report their medical loss ratio (MLR) on an annual basis. The MLR is the percentage of premiums an insurer spends on medical claims and quality improvement initiatives. The purpose of the new requirement is to provide an incentive for insurers to spend more of their premium revenue on members' medical care, since insurers that fail to maintain the required MLR will be required to rebate the difference to their members.

The Centers for Medicare & Medicaid Services (CMS) released a revised version of the 2011 Medical Loss Ratio Annual Reporting Form in April. The Academy's MLR Regulation Work Group in a May 2 letter to CMS outlined several concerns with the revised form and recommended ways to improve the form and/or reporting form instructions.

Assessing Medicare's Financial Status

MEDICARE'S projected financial condition continues to deteriorate, warned the Academy's Medicare Steering Committee in its annual issue brief that offers an actuarial perspective on Medicare's financial condition and outlines available public policy options to address the program's long-term financial challenges. The committee updated the brief following the release in late April of the 2012 Medicare Trustees Report. The trustees reported that the Federal Hospital Insurance Trust Fund (HI) will be depleted in 2024—the same year as projected a year ago—but that the 75-year HI deficit increased from 0.79 percent of taxable payroll in last year's report to 1.35 percent in the 2012 report.

HEALTH BRIEFS

- **Jeffrey Petertil**, an actuary in Oak Park, Ill., has been appointed chairperson of the Academy's Joint Committee on Retiree Health.

LTC Practice Note Exposed

THE ACADEMY'S Long-Term Care Practice Note Work Group has released for comment an update of the 2003 practice note on long-term care rate stability. *Long-Term Care Insurance Compliance with the National Association of Insurance Commissioners Long-Term Care Insurance Model Regulation Relating to Rate Stability* provides non-binding guidance for pricing long-term care insurance under the rate stability provisions of the long-term care insurance model regulation adopted by the National Association of Insurance Commissioners in 2003 and amended in 2009.

The updated practice note addresses:

- Requirements of the pricing actuary;
- The process for pricing initial premium rates;
- The process for preparing premium rate increases for in-force policies; and
- Reporting requirements for rate filings and certifications.

Comments on the practice note should be sent to StateHealthAnalyst@actuary.org by May 31, 2012.

Banks and Insurers Face Different Risks

THE RISKS ASSUMED BY INSURERS are fundamentally different from those assumed by banks, the Academy's Financial Regulatory Reform Task Force wrote in an April 30 letter to the Board of Governors of the Federal Reserve System. The task force's comments were in response to a proposed rule that would establish prudential standards for non-bank financial service companies identified by the Financial Stability Oversight Council as companies whose business activities or financial distress could pose a threat to the financial stability of the United States.

Making insurers comply with standards developed for the banking industry would have the unintended consequence of impairing the insurers' competitive position for reasons unrelated to the risks they assume, the task force wrote. The task force recommended that enhanced prudent standards for insurers be developed based on an understanding of the unique features of the risks assumed by insurers, the differences between bank and insurer business models, and the function of insurance industry regulation.

Academy Submits Comments to NAIC

IN AN APRIL 30 letter to the National Association of Insurance Commissioners (NAIC), several Academy public policy groups commented on the NAIC's draft white paper on the solvency modernization initiative (SMI) and insurance regulation. The joint letter from the Solvency Committee, the Property/Casualty Risk-Based Capital (RBC) Committee, the Casualty Practice Council, the Health Solvency Work Group, and the Life Practice Council included suggestions encompassing RBC, Own Risk and Solvency Assessment (ORSA), and the NAIC model laws.

The letter included comments intended to educate readers not fully familiar with the U.S. regulatory system and were developed to reflect the perspective of practicing actuaries in the United States.

The NAIC released the white paper as part of its ongoing initiative to examine the effectiveness of the current U.S. solvency framework of all lines of insurance and develop a road map for future changes.

In a May 11 letter to the NAIC, the Enterprise Risk Management (ERM) Committee commented on the NAIC's draft ORSA Model Act. The act specifies requirements for completing an annual ORSA and guidance and instructions for filing an ORSA Summary Report. The ERM Committee's comments included suggestions regarding the ORSA requirements and exemptions from the requirements, specifically the treatment of captive insurers.

Actuarial Science Needed

ACTUARIAL SCIENCE should be one of the specific considerations for members of the proposed Financial Research Advisory Committee that will support the work of the Office of Financial Research (OFR), Maryellen Coggins, vice president of the Risk Management and Financial Reporting Council, wrote in an April 13 letter to the Department of the Treasury. The letter was prompted by a March 22 announcement in the *Federal Register* about the establishment of the Financial Research Advisory Committee.

"Given that a major focus of the OFR's work is in support of the Financial Stability Oversight Council (FSOC), and the FSOC in turn is charged with comprehensive monitoring of financial services, including insurance, and is specifically, by statute, required to report on 'significant financial market and regulatory developments, including insurance and accounting regulations and standards,' I was dismayed that the skill sets identified for membership on the Committee did not include actuarial science," Coggins wrote.

Only experts in the fields of economics, financial institutions and markets, statistical analysis, financial markets analysis, econometrics, applied sciences, risk management, data, information standards, and technology are mentioned in the announcement establishing the committee.

Actuaries are needed on the advisory committee, Coggins explained, because much of the information that the committee is expected to examine will emanate from actuaries in the insurance industry. And actuarial oversight at the federal regulatory level is crucial to fully assess the industry's actuarial work product.

RISK MANAGEMENT AND FINANCIAL REPORTING BRIEFS

➡ **Matthew Clark**, principal for Deloitte Consulting in Chicago, has joined the council's ERM Committee.

Improving PBGC's Stability

ANY PROPOSED CHANGES to the Pension Benefit Guaranty Corp. (PBGC) premium structure—changes intended to improve the PBGC's financial stability—should evaluate and address going-forward costs and legacy costs separately, the Pension Practice Council wrote in a new issue brief, *Examining the PBGC Premium Structure*.

The brief describes going-forward costs as "true insurance costs" that are associated with the risk of covering unfunded benefits arising from future bankruptcies and insolvencies among currently viable plan sponsors. The premiums for going-forward costs should be both adequate and appropriately risk related, the brief emphasized.

Legacy costs are the costs associated with existing or imminent claims on the PBGC, such as the unfunded liability for plans that are already in the hands of the PBGC or that are expected to be in its hands in the near future. These costs already have been incurred, the brief states, so they are not insurable future events. Including legacy costs in an insurance model would drive up the cost of insurance to a level that exceeds the true value of the coverage, creating both a financial incentive for plan sponsors to exit the defined benefit system and an impediment for establishing new plans.

While determining who should pay for the legacy costs is a policy issue—not an actuarial issue—the brief outlines a number of options for allocating costs. Immediate action needs to be taken to stabilize the PBGC deficit; however funding the deficit is important but less urgent. The PBGC assets on hand are sufficient to pay beneficiaries for many years without cash flow difficulty.

Policymakers currently are looking at ways to revise the PBGC premium structure to improve its financial stability. A proposal submitted by the Obama administration as part of its 2012 budget request would tie the variable premium more directly to the risk each plan poses to the PBGC but leave the mechanics of that increased correlation to the PBGC board of directors.

"Without sufficient detail from the PBGC regarding how a model would operate, there is little upon which to form an opinion," the brief states. "Any model that the PBGC might develop would benefit from public exposure to proposed levels of adequacy and risk-related premiums."

Social Security Outlook Weakens

THE DAY OF RECKONING when the Social Security trust fund is projected to run out of money is now 2033—three years earlier than forecast last year—according to the 2012 Social Security Trustees Report released in late April. The trustees' latest findings are reflected in two updated issue briefs released by the Academy's Social Security Committee.

An Actuarial Perspective on the 2012 Social Security Trustees' Report takes a closer look at the trustees' numbers and examines public policy options to address Social Security's long-term financial soundness. Congress needs to take prompt action to restore the long-term financial outlook of the program so that reforms can be phased in over many years and multiple generations of retirees, the brief states. The goal for any modifications to the system should be not only to make the program solvent for the next 75 years but also to ensure that the trust fund reserves are stable or increasing at the end of the 75-year period.

Understanding the Assumptions Used to Evaluate Social Security's Financial Condition describes the major assumption used by the Social Security Board of Trustees, the Congressional Budget Office, and outside experts when making projections. The Academy brief also examines how variations in the assumption affect the results. The issue brief encourages complete disclosure of the assumptions used and emphasizes the importance of applying assumptions consistently when comparing alternative proposals for the Social Security program.

Annuities Addressed in Letters to IRS

THE ACADEMY'S PENSION COMMITTEE submitted two comment letters to the Internal Revenue Service in May in response to proposed regulations for annuity distribution options and longevity annuity contracts.

The committee in a May 3 letter expressed support for proposed regulations that would facilitate partial annuity distribution options in defined benefit pension plans. It also provided suggestions on transition issues and on the proposed structure of exemptions.

Proposed regulations on longevity annuity contracts that would allow the use of retirement funds as a vehicle to protect against longevity risk are a much-needed step that would help provide financial security to American workers, the committee wrote in a second letter to the IRS. The committee also recommended several modest changes—such as allowing defined benefit pension plans to offer qualified longevity annuity contracts—to improve the proposed regulations.

with generally accepted actuarial principles and practices." It also noted that "in applying the term as a description of actuarial work, it becomes incumbent upon the actuary to provide the support and documentation necessary to show users that the work has been done with skill and care by a qualified practitioner."

Ackerman said that she hopes the report will help policymakers and legislators see the benefit of being more precise when using these terms. This could be achieved by including a reference to a particular Actuarial Standard of Practice or Statement of Principle in the statute or rule, for example, or by adding instructions to address the desired funding levels from premium and non-premium sources in the case of catastrophe programs.

Also serving on the task force were Steve Alpert, Lee Barclay, Donna Novak, Arthur Panighetti, John Pedrick, and Kevin Russell.

Viewpoint

Sounding Off on Soundness

BY RADE MUSULIN

THE ACADEMY'S SPECIAL REPORT on actuarial soundness provides an excellent review of the concept in all practice areas. I urge you to read it, particularly if you work in public policy development or ratemaking.

The term "actuarially sound" has been creeping into statutes at both the state and federal levels for many years. In the casualty arena, it is generally used by well-intentioned people who (often mistakenly) assume that directing an entity such as a flood program or windpool to adopt actuarially sound rates will reduce or eliminate deficits and allow actuaries to determine unambiguously what the appropriate rate is. But such a requirement unfortunately is not a magic elixir that will eliminate deficits, nor does it provide clarity as to how to establish rates.

Government insurance pools usually are created to solve an affordability or availability problem arising from an inability of private insurers to charge what they consider to be actuarially sound rates and/or for consumers to afford to pay such rates. Pools have various funding sources (assessments, levies, or taxes) external to the policyholder base to bridge the gap. Determining the proportion of pool funding that needs to come from policyholder premiums vs. other sources is beyond the scope of actuarial standards; direction must be provided to actuaries as to the expected contribution of various funding sources to loss costs.

This issue is particularly important in pools that cover catastrophic losses from earthquakes, floods, or hurricanes. Rates in such pools have to consider not only the appropriate provision for expenses and long-term loss costs but also whether a loading for the cost of capital is appropriate. Private entities offering coverage against catastrophic loss must hold capital or buy reinsurance to cover losses in excess of current-year revenue and reflect such costs in their rates. In addition, all losses in private entities must be funded in advance. Government pools covering catastrophic loss, on the other hand, can borrow funds from the Treasury—as the National Flood Insurance Program has. Or they can issue post-event bonds funded by assessments on a broad population—as the Florida Hurricane Catastrophe Fund (FHCF) has. This means that not all costs associated with a transfer of risk from a policyholder to a government pool have to be reflected in the rate charged by the pool.

The balance between the revenue generated by policyholders at risk of loss and from the "assessed masses" obviously is a critical public policy consideration in designing a government pool. Getting that balance right requires direction from elected officials. Simply mandating that pool rates be actuarially sound does not provide actuaries with enough information to determine appropriate premium levels.

I faced this issue head-on when I served on the Advisory Council of the FHCF. The FHCF had been formed specifically to offer reinsurance coverage to Florida insurers at a cost below that which was commercially available at the time. Unlike private reinsurers, it had the ability to issue post-event tax-exempt bonds to fund losses. Repayment of the bonds was funded by assessments on insurance policies, including policies, like auto policies, that were not covered by the FHCF.

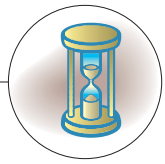
It was proposed that FHCF reimbursement premiums be set at a level equal to long-term expected losses and expenses without a risk load for capital costs. I was involved in some long discussions as to whether such premiums were "actuarially sound." I eventually concluded that I was unable to state they were unsound, since the legislature had specifically created the FHCF to offer a source of low-cost capacity and provided a funding source to cover deficits from outside its policyholder base. Whether such premiums were "fair" or economically appropriate was a legislative issue outside the actuarial realm.

I was once asked by a Florida legislator what the effect would be of mandating that rates for Citizens Property Insurance Co. (the property residual market) be actuarially sound. To his great surprise, I replied that I did not know—because actuaries had no idea what actuarial soundness meant in the context of Citizens without some direction from policymakers.

Now, thanks to the thorough work of the Academy's Actuarial Soundness Task Force, we are in a better position to answer that question. Unfortunately for those seeking a silver bullet for difficult questions of ratemaking in government pools, the task force concluded:

"While not all publicly based catastrophe programs rely on outside sources of funding (e.g., taxpayer dollars or assessing a broader policy base), when they do, additional examination is needed to evaluate actuarial soundness. Instructions in the enabling legislation are necessary to address the level of funding that is expected from premium income and the level that is intended to come from non-premium sources."

Rade Musulin is a casualty actuary based in Sydney, Australia. He is a longtime Academy volunteer who currently serves on the Property/Casualty Extreme Events Committee, the Flood Insurance Subcommittee, and the Terrorism Risk Insurance Subcommittee.



Group Updates Interest Rate Generator

THE ACADEMY/SOCIETY OF ACTUARIES (SOA) Joint Economic Scenario Generator Project Oversight Group has released a Frequently Asked Questions paper that answers many of the questions about the Academy's economic scenario generators. The group also updated the interest rate generator with historical yield curves through December 2011. The interest rate generator was originally developed by the Academy's Economic Scenario Work Group and released in 2008. In December 2011, the Academy and the SOA joined resources to manage the economic scenario generators used in regulatory reserve and capital calculations. (See the December 2011 *Update* for information about the group.)

Academy Advising NAIC on C1 Factors

THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC) has formed a new committee to review and update the C1 component of the Life Risk Based Capital (RBC) formula. The C1 component defines the minimum capital requirements for investment risks such as credit risk. Nancy Bennett and Jerry Holman, the co-chairpersons of the Academy's C1 Work Group, are serving as advisers on the NAIC's C1 Factor Review Subgroup. The Academy's C1 Work Group is developing a framework for the C1 component. The current focus of the work group's efforts is the creation of a calculation engine to support the development of bond RBC factors, including the model assumptions and representative portfolios that are used as inputs to the model.

In a May 1 report and presentation to the NAIC C1 Factor Subgroup, the Academy work group outlined the general mechanics and assumptions of the current C1 bond factors and assumptions that will need to be defined in updating the C1 factors.

LIFE BRIEFS

- **Cande Olsen**, vice president of Actuarial Resources Corp. in Chatham, N.J., has been appointed chairperson of the Academy's newly formed Separate Account Products Work Group. Other Academy members forming the group are **Noel Abkemeier**, consulting actuary and principal for Milliman in Williamsburg, Va.; **Thomas Campbell**, vice president and corporate actuary for The Hartford Life Insurance Co. in Simsbury, Conn.; **Lee Hakert**, associate actuary for Transamerica Life Insurance Co. in Cedar Rapids, Iowa; **David Hippen**, life and health actuary for the Missouri Department of Insurance in Jefferson City; **Stephen Krupa**, an actuary for TIAA-CREF in New York; and **Gabriel Schiminovich**, vice president, product development for M Financial Group in Portland, Ore.
- **Corinne Jacobson**, assistant vice president, annuity valuation for Midland National Life Insurance Co. in Fargo, N.D., and **David Stalker**, assistant actuary for Aegon Insurance Group in Cedar Rapids, Iowa, have joined the Academy's Annuity Reserves Work Group. **Chuck Souza**, a senior consultant for Towers Watson in St. Louis, has joined the Academy's Annuity Reserves Analysis Subgroup.
- **Douglas Lubliner**, corporate vice president and actuary for New York Life Insurance Co. in Sleepy Hollow, N.Y., and **Stephen McNamara**, vice president and actuary for New York Life Insurance Co. in New York, have joined the Academy's Nonforfeiture Modernization Work Group.
- **Marc Whinston**, an actuary for Teachers Insurance and Annuity Association in New York, has joined the Academy's Deposit Fund Subgroup.
- **Jeffrey Johnson**, assistant vice president and actuary, U.S. division for John Hancock USA in Boston, has been appointed chairperson of the Academy's Invested Asset Work Group.
- **Linda Lankowski**, an actuary for The Hartford in Simsbury, Conn., has been appointed chairperson of the Academy's Government Mandates Subgroup.
- **Mary Elizabeth Caramagno**, an actuary for Prudential in Newark, N.J., has joined the Academy's Tax Work Group.

Actuarial Update

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