THE ACTUARIAL
UPDATE
VOLUME 25 ▪ NUMBER 2 AMERICAN ACADEMY OF ACTUARIES FEBRUARY 1996

Academy Warns of Flat-Tax Danger to Pensions

A flat tax could erode the foundations of the American system of private pensions, Academy Senior Pension Fellow Bob Heitzman warned in a January statement to the National Commission on Economic Growth and Tax Reform. The commission, established by Republican congressional leaders and chaired by former Housing Secretary Jack Kemp, released its report to the public at a January 17 Washington news conference.

The radical overhaul of the United States tax system has emerged as an early key issue in the 1996 presidential campaign, with both publisher Steve Forbes and Sen. Phil Gramm (R.-Texas) advancing flat-tax plans. The Academy issued its report to ensure that tax reform's effect on pension plans is not overlooked in the public debate.

In an exchange following the Kemp Commission's news conference, Heitzman asked Kemp if his group had seriously considered tax reform's effect on employment-related pension plans. Kemp's response: "Yes, we have, and the commission considers it imperative that the current tax status of pensions not be compromised one iota." According to Heitzman, "While the pension issue needs to be followed up as tax reform gets serious congressional attention, it is comforting to know that the actuarial profession's concerns are part of the mix."

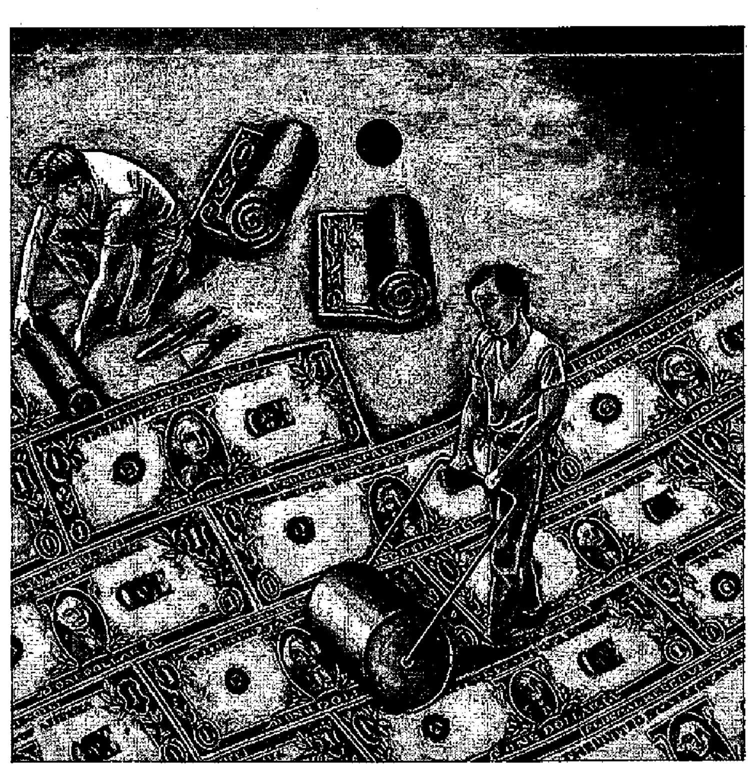

Illustration: © Jane Marinsky/SIS

In his statement, delivered to the commission before its report was made public, Heitzman wrote, "Fundamentally changing the tax code will precipitate a ripple of changes throughout the entire economy. The country's private pension system could be an unintended casualty." Since World War II, the private pensions have been the most successful form of savings—encouraged by tax incentives for employers and employees built into the present. "If all forms of savings were given tax-favored treatment, employment-linked pensions would be jeopardized. Losing this major source of private savings would ultimately work counter to the goal of increasing the national savings rate," added Heitzman.

Heitzman based his statement to the Kemp Commission on his October report, "Pensions in a Flat World," which examines the effects on private pensions of the flat tax, consumption tax, wage tax, and value-added tax. The study was published to provide the American public and commission with accurate pension analysis as tax reform is debated throughout the year.

"This is a good example of the Academy providing information to the American public and elected officials on an issue important to actuaries. Tax reform will be one of the most contentious issues discussed in 1996, and the proposed tax initiatives and their impact on pensions are important factors to consider before supporting or opposing any of the plans," said said Academy Executive Director Wilson W. Wyatt, Jr.

While the Kemp Commission offered no specific recommendations, Heitzman has studied the two leading proposals now before Congress. Under the wage tax bills sponsored by House Majority Leader Dick Armey (R.-Texas) and Sen Arlen Specter (R.-Penn.), return on all investments would be tax-exempt, an advantage available now only to qualified retirement plans," said Heitzman. Consumption tax proposals sponsored by Sen. Sam Nunn (D-Ga.) and Sen. Pete Domenici (R.-N.M.) would grant immediate tax deductions for all amounts saved, deferring taxation until that money is drawn down for consumption. For the most part, only qualified pension plans are treated like that now. Others are advocating a national value-added tax or retail sales tax, replacing the personal income tax system altogether. That would make the current tax incentives for pensions irrelevant.

The Academy report suggests if any of these legislative proposals were passed in current form, there could be an increase in the total amount saved by individuals and households in the US., but it likely would be concentrated among those with higher incomes. Pension plans would quickly diminish in number and size and might gradually disappear. Over time, there would be additional pressure and greater need for the government to intervene through increases in Social Security benefits or other retirement income measures.

If private pensions are to continue to support the retirement of middle-income workers, the proposals need to provide an alternative tax incentive for employer-sponsored pensions. This can be done through including a partial tax credit for contributions to qualified pension plans or mandating employer-sponsored retirement plans.

Heitzman's statement to the Kemp Commission yielded media attention for the Academy in the form of a television interview on *First Business*, a nationwide business news show, and an article in the January 18 *USA Today*.

As the tax reform debate unfolds, the Academy will continue to offer the actuarial profession's analysis of the potential impact of a flat tax on health insurance, annuities, and other private savings mechanisms.

TO OBTAIN A COPY OF THE ACADEMY'S FLAT-TAX REPORT, FAX A REQUEST TO CHRIS DELTA AT 202-872-1948.

IN BRIEF

Pitfalls in Ky. Reforms Cited

Premium caps could add to the risk of health insurer insolvencies if not carefully implemented, the Academy State Health Committee cautioned Kentucky Gov. Paul Patton on December 22.

The Academy letter responded to outgoing Gov. Brereton C. Jones's implementation regulations for HB 250, the recently passed Kentucky health care reform law. Jones accused health insurers of gouging consumers and ordered companies to lower their rates by December 11, his last day in office.

State Health Committee Chairperson Peter Perkins said, "The risk to the solvency of a health insurer under health insurance reform will be greatest during the initial years of implementation. Reforms can increase risk at the onset, in part, because the benefits, insureds, carriers, and rates are all in a state of flux, thus increasing uncertainty, thus increasing risk. Therefore, careful consideration must be given by regulators when such premium limitations are imposed on health insurer."

The State Health Committee has provided technical assistance to the Kentucky Insurance Department on a number of HB 250 implementation issues, and Perkins invited the department to contact the Academy to discuss ways to minimize the risk of insolvency.

In his letter to Gov. Patton, Academy Executive Director Wilson Wyatt warned that "Fundamental changes in how the private health insurance market operates could increase the solvency risk of health insurers as well as threaten the objectives of the health care reform legislation."

Wyatt's letter also points out that in HB 250, premium limitations and rate restrictions limit a health insurer's ability to reflect expected costs or changes in costs, and they can add to the carrier's financial risk. Health insurance premiums are normally set for only one year. The ability for individual health plans to adjust premiums annually limits their financial risks. Any restriction, including a premium cap, that limits the ability to raise rates or the frequency with which rates can be adjusted could increase the health plan's risk."

Wyatt also outlined the Academy's view in letters to the editors of the Louisville Courier-Journal and the Lexington Herald-Leader that were published in mid-January.

To obtain a copy of the Academy letter on Kentucky health premium rate restrictions, fax a request to Chris Delta at 202-872-1948.

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COLI Okays Guideline XXX

Randy Mire

Guideline XXX is actuarially sound, according to the Academy Committee on Life Insurance (COLI). The guideline is the National Association of Insurance Commissioners (NAIC) model regulation on the valuation of life insurance policies, which the NAIC adopted in March 1995.

In June 1995, the NAIC task force requested COLI's analysis of the controversial guideline, asking specifically if the model regulation was technically correct under the commissioner's reserve valuation method (CARVM), and if reserves under Guideline XXX were sufficient for insurer solvency. COLI responded in a November 29 letter to Frank Dino, chairman of the NAIC Life and Health Actuarial Task Force. COLI's letter did not endorse the regulation, but answered the NAIC's specific questions.

In the letter, COLI Chairperson Randy Mire wrote that the regulation "provides a reasonable interpretation of the statutory reserving method for certain types of policies . . . at a consistent level as other policies covered by CARVM."

On the question of solvency, Mire noted competing notions of the public interest. It's a public policy decision whether larger reserves should be required at the expense of higher premium costs to consumers, he stated. The reserves under the regulation "are more consistent with the level of reserves required of other life insurance policies."

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Applying Theory Is Conference Focus

Applying economic theory to actuarial science is the theme of the 1996 Actuarial Research Conference.

Cosponsored by the Academy and the Society of Actuaries, the conference will be held August 15–17 at Ball State University in Muncie, Indiana. Presentations relating to the theme or other actuarial topics are welcome; conference papers will be published in the *Actuarial Research Clearing House.*

Elias Shiu and Bruce Jones of the University of Iowa are coordinating the conference with the assistance of William Frye of Ball State University. For more information, drop by the conference World Wide Web Site: http://www.cs.bsu/homepages/math/31stARC.html. Or contact Judy Yore of the Society of Actuaries at 708-706-3500.

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Academy Explains Standards to Quinn

Two columns by financial writer Jane Bryant Quinn that questioned the professionalism of actuaries have drawn an Academy rebuttal in a letter from Executive Director Wilson Wyatt, Jr.

In a January 7 column on life insurance illustrations, Quinn called actuarial certification a "clear gain for consumers," but stated that "actuaries are usually influenced by what the company wants." Wyatt's response pointed out that actuaries—insurance company employees and consultants alike—are governed by the standards of practice of the Actuarial Standards Board and the Code of Professional Conduct. Failure to comply could bring an actuary before the Actuarial Board for Counseling and Discipline, he noted.

Wyatt also commented on a December 17 Quinn column that refers to an employer survey conducted by enrolled actuary Theodore Konshak. Seventeen of the twenty surveyed companies made lower pension contributions after replacing their actuary. Wyatt stated that the survey's results do not imply that "circumventing or ignoring standards of practice is widespread among actuaries." Larry Sher, vice chairperson of the Academy Pension Practice Council, also wrote Quinn to detail the flaws in the survey's methodology.

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Myers Award Nominations

The Academy Committee on Actuarial Public Service is now accepting nominations for the Robert J. Myers Public Service Award.

The Myers Award is presented to an actuary who has made an outstanding contribution to the common good through service to government or other organizations in the public sector. In addition to honoring an individual actuary, the award also calls attention to the significant benefits the general public receives from the work of the actuarial profession.

The award is named for Robert J. Myers, who as chief actuary of the Social Security Administration from 1947–70 was instrumental in the design and funding of the U.S. Social Security system. The first award was presented in 1995 to John O. Montgomery, former chief actuary of the California Department of Insurance.

A postal reply card for nominations is included with this month's *Actuarial Update;* the deadline for nominations is March 15. The award medallion will be presented at the Academy Annual Meeting in November in Boca Raton, Fla.

FROM THE PRESIDENT — WILSON W. WYATT JR.

Taking a New Direction

Wilson W. Wyatt Jr.

In 1995 we set a new course for the Academy, one that allows actuaries to participate more effectively, on a timely basis, in the discussion of public issues in Washington and at the state level. In setting this new direction, we are carrying out a vision articulated by leaders of the entire profession. Our charge is to raise the visibility and credibility of the actuarial profession with those who make our laws and regulate our businesses, as well as with the media and the general public.

Actuaries are uniquely placed to offer significant, unbiased knowledge to the public policy process, yet their contributions are often unrecognized. Our task is to build understanding of those contributions.

Too little is known about the important standard-setting and counseling and disciplinary activities that the Academy supports on behalf of the entire profession. These professionalism responsibilities involve a continuous—and remarkable—volunteer effort that demonstrates the seriousness with which the profession upholds its standards. To build the profession's credibility with employers and regulators, the Academy also must make this effort known.

Over the past year we have succeeded in raising actuaries' visibility with audiences important to the profession. During recent meetings on Capitol Hill, congressional staff have eagerly sought our assistance on a wide range of issues—tax policy, Superfund, retirement income, Medicare, managed care, and a variety of insurance-related questions. In 1996, we plan to meet more frequently with members of Congress and to reach out to states that have a vital need for our assistance on emerging issues of great public importance.

The Academy will also conduct a more aggressive communications program. We will intensify our efforts to inform the news media and research organizations about actuaries' public policy contributions. And more than ever before, we will communicate the profession's successes to the business community, where future employment opportunities for actuaries will be found.

Working together through the Academy, individual actuaries from all practice areas can have a significant impact on the public issues that affect their work and professional interests. In 1996 the Academy—with the support of our members and the energy of our volunteers—will continue on its new direction of building greater credibility and visibility for the entire profession.

'Actuaries Are Essential to Financial Reporting'


Barbara Snyder

Financial reporting is an increasingly important professional responsibility for actuaries. In 1994 the Academy established a steering committee to coordinate activities regarding financial reporting across all practice areas. Barbara Snyder, the current chairperson of the Financial Reporting Steering Committee, recently answered a few questions for the *Update* about financial reporting and the work of her committee.

Why is financial reporting important to the actuarial profession?

Financial reporting is important not only to the actuarial profession but to the insurance and pension business, the business community, and to the public—especially policyholders. As a professional, the actuary is uniquely qualified to contribute meaningful information to the financial reporting process for insurance and other similar enterprises, and to ensure that the financial reports produced are appropriate, accurate and clear.

What types of financial reports do actuaries prepare?

Actuaries prepare many different types of financial reports. These reports may be produced for use by internal management, to meet the needs of the business community, stockholders, employees, or policyholders, or to satisfy specific regulatory requirements. Some types of reports are similar by actuarial specialty, while others relate only to a specific area of work, e.g. federal government forms required for pension plans.

For which regulatory entities do actuaries develop reports?

Actuaries develop reports for many different regulatory entities. Some are required reports, such as those required by state insurance department or the Securities and Exchange Commission, and some are informational reports, such as white papers on certain topics for the Federal Accounting Standards Board.

What is the actuary's relationship to other financial professionals—accountants, for instance—in the financial reporting arena?

Our relationship is much the same as that between any other professionals. That is, as actuaries, we have a unique set of skills and knowledge about our field of expertise within the insurance and pension industries that is needed to produce sound financial reports. We work with accountants, as well as other professionals, to meet the needs of the constituencies involved.

How does the Academy's Financial Reporting Steering Board improve the profession's ability to respond to financial reporting issues?

The committee coordinates all financial reporting activities across practice lines. It acts as a liaison to other committees within the profession and to the accounting professions and regulatory bodies. It creates and oversees special cross-disciplinary task forces on an as-needed basis. The committee also serves as a counterpart to the AICPA's Committee on Relations with Actuaries, which provides a facility for communication between the actuarial and accounting professions.

How does the committee interact with other Academy committees, such as the Committee on Property Liability Financial Reporting and the Committee on Life Insurance Financial Reporting?

The other committees focus on issues for one practice area. The chairs of these committees or their representative serve on the Financial Reporting Steering Committee. I act as a liaison to bring to these committees issues that need coordinated attention across practice lines, and the other members of the Financial Reporting Steering Committee give input as to approach to address particular issues, reaction and action by their various committees, and help in forming tasks forces as necessary to address particular issues.

Communication is key. Although we do not feel that every issue that is brought up requires cross-functional attention, we have a chance to determine which are cross-functional and which need particular attention by one practice area. In the case where the issue needs to go back to one practice area, I make sure that the appropriate committee is addressing it.

In the long term, how important is the financial reporting function to the profession's future? Is it a source of new employment? A high-profile role that will open other doors?

I think a better questions is how important is the actuary to the financial reporting function, and the answer to that is, not only very important, but essential.

As financial requirements become more complex and more numerous, as we have seen recently in the valuation actuary requirements for life and property/casualty actuaries, actuaries must be more highly trained and knowledgeable abo[illegible] aspects of the business. This could certainly lead to many opportunities in any practice area for actuaries as their knowledge, skills, and contribution are recognized.

Clinton, Congress Don't Get Medicare Reform Right: Academy Work Group Points Out the Flaws

The Academy Medicare Work Group has discovered flaws in both Republican and Democratic Medicare reform plans, according to the report of the Academy Medicare Work Group released on December 21.

The future of Medicare is at the center of the current budget impasse between Congress and the administration and is expected to be a key issue in the November elections. The Academy group studied the Republican-sponsored Medicare Preservation Act (MPA) at the request of House Speaker Newt Gingrich and also examined President Clinton's counterproposal.

While the Academy group was critical of the details, it praised both proposals for attempting to improve Medicare's financial status. For example, according to Work Group Chairperson Guy King, the fiscal controls in the MPA, which Clinton vetoed in December, would go a long way toward solving the program's long-term economic problems. "That's the good news," said King. "The bad news is that in solving these budgetary problems, the MPA may jeopardize access to high-quality care for all those who remain in the traditional fee-for-service Medicare plan."

The Academy report also leveled sharp criticism at an accounting trick in the president's proposal that makes the Medicare Hospital Insurance (HI) program appear to meet short range solvency standards established by the HI Board of Trustees. "This sort of fiscal sleight of hand gives the appearance of having solved a problem, but in reality only serves to undermine fiscal discipline,"said King. "The President's proposal has more important defects than the MPA and can be considered only a stopgap measure. It is similar to the quick fixes enacted in the past that have allowed the Medicare program to fall into its current financial state."

The Academy report did more than criticize, however. The group proposed seven measures for sound reform, including less reliance on provider payment reductions to achieve savings and long-range recognition of HI financial problems

The report also endorsed stronger financial incentives for Medicare beneficiaries to use managed care plans, called MedicarePlus under the Republican proposal. Currently, the Medicare capitation program is restricted to HMOs. The new proposals would open Medicare up to provider service organizations capable of assuming risk and providing health care to the Medicare population. The president's proposal is considerably more restrictive than the MPA, which would open the program to virtually any organization able to ensure quality care and assume the attendant financial risk.

Both programs rely heavily on reductions in unit payments to physicians and other health care providers to achieve savings. "Reducing unit payments won't produce incentives for reducing the rate of growth in health expenditures," said King. In addition, both plans give health care providers an alternative payment mechanism that they can choose from to maximize their revenues from Medicare. Therefore, it's not likely that the MedicarePlus program will have a favorable impact on Medicare costs

Other members of the Academy Medicare Work Group are David Axene, Ron Bachman, David Kerr, Water Liptak, Robert Lynch, Harry Sutton, John Wilkin, and David Wille.

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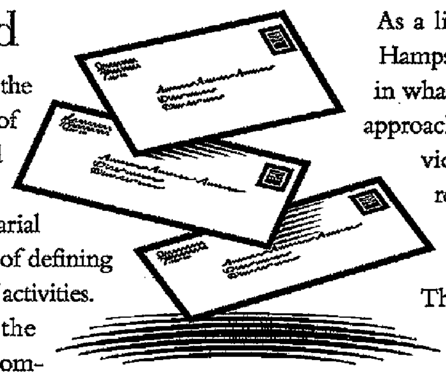
LETTERS TO THE EDITOR

Academy Progress Praised



I'm very impressed and encouraged by the relevance the Academy has achieved as it plays its unique role of providing objective information to regulators and legislators on complex insurance and benefit questions. Equally impressive is the work of the Actuarial Standards Board in what must be a herculean task of defining standards of practice for actuaries in diverse areas of activities.

The goals that all of us, as past leaders of the Academy, had hoped to achieve now seem to be coming into fruition through the dedicated work of so many.

I'm also taken by the excellent publications of the Academy, such as your *1995 Report to the Membership*. The progress, and the effort, seem very obvious. Keep it up!

Bill Halvorson
NAPLES, FLA.
Halvorson was president of the Academy in 1981–82.

Was Report Necessary?

I recently received a copy of the *1995 Report to the Membership*, printed in multiple colors on quality paper. Is the information in this report so important that it justifies the expense? Couldn't all the pertinent information have been published in the *Update*? I'm not convinced that it was money well spent. The Academy Board of Directors should consider very carefully whether to authorize any such reports in future years.

William E. Neal
CINCINNATI, OHIO

The managing editor replies:
Over the course of the last year, the Update *reported on all the issues covered by the report. However, not all members read the newsletter as thoroughly as we'd like. The goal of the* 1995 Report *was to summarize a year of Academy activities in a brief, easily accessible form. After all, the Academy's work on behalf of the profession depends on members' volunteer efforts, and making sure that you're informed is a top priority. The cost considerations you raise were taken into account when the Academy communications staff planned the report, and we continue to believe it was a good use of our communications resources.*

The following letter might convince you that the 1995 Report *was an effective vehicle for communicating the Academy's message.*

Report Yields Regulator Request

In the *1995 Annual Report to the Membership*, under the Health/States Section, the following was reported: "As the health care reform debate moved out of Washington, the Academy State Health Committee advised governments and regulators in eleven state capitals on such issues as risk adjustment, community rating, risk-based capital, and small-group market reform."

As a life, accident, and health actuary with the New Hampshire Insurance Department, I would like to know in what capacity was this advice offered? Did these states approach the Academy? Was such advice offered and services performed on a fee-for-service basis? Are the recommendations, findings, and advice that was provided these eleven states available to other states or the public?

This department may be interested in seeking similar services from the Academy. We look forward to your reply.

David Sky
CONCORD, N.H.

The managing editor replies:
Part of the Academy's mission is ensuring that regulators have the technical actuarial advice they need to make sound policy decisions. The Academy does not charge for the services of its volunteers. Your letter has been forwarded to the State Health Committee, which will contact you to discuss specific assistance for the New Hampshire department.

Standing on Principle

Two items in the December 1995 *Update* touch on very important issues for the Academy and the actuarial profession.

First, I would like to see more dissenting opinions on important issues such as those presented by Fred Kilbourne ("The Emperor's Wardrobe"). Whether one agrees or not, it is refreshing to see that an ASB member can publicly disagree with the majority on an important issue. I don't know enough to comment on the merits of the particular issue (certification of small employer health plans), but I agree wholeheartedly with his general comments on the responsibility of the actuarial profession when confronted with conflicts between professional principles and standards drafted to comply with government regulations.

The second item was from the interview with John Montgomery, former Chief Actuary of the California Insurance Department, who made the very important point that the profession needs to maintain its independence from both industry and regulators. It is easy to understand how some regulators at times have the perception that actuaries use the Academy to do the bidding of their employers. If we are to be respected as a profession, as opposed to just an industry's technical group, then we should be willing to take stands and express opinions based on principles, even when those principles appear to conflict with the apparent interests of our employers or regulatory bodies.

By openly acknowledging these differences, we will be encouraging both the reality and perception of our professional independence. As a result, it will be more likely that we'll have the courage to say what we believe is right, regardless of whom we may be at odds with. It will also be more likely that others will actually believe what we have to say.

Chuck Ritzke
WEST DUNDEE, ILL. VIA COMPUSERVE

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