THE ACTUARIAL UPDATE

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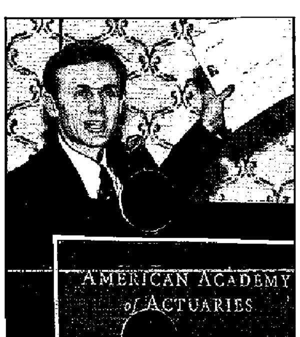
PENSION NEWS

Gebhardtsbauer Named Senior Pension Fellow

Ron Gebhardtsbauer has been selected Academy senior pension fellow, Academy President Jack Turnquist and Executive Director Wilson W. Wyatt announced on May 1. As senior pension fellow, Gebhardtsbauer will be the actuarial profession's chief public policy liaison on pension issues. Gebhardtsbauer comes to the Academy from William M. Mercer, Inc. in New York, where he was a principal and head of retirement practice. He will begin his Academy duties May 28.



Gebhardtsbauer reported on Pension Practice Council activities at the 1995 Academy Annual Meeting.

"My job is to increase actuaries' credibility and provide unbiased information through the Academy," said Gebhardtsbauer. "As Academy pension fellow, I hope to bring the views of *all* actuaries to Congress."

Gebhardtsbauer brings extensive Washington experience to his Academy post. From 1986 until 1994, he served as chief actuary for the Pension Benefit Guaranty Corporation. He also served as enrolled actuary for the Office of Personnel Management and consulting actuary for the Wyatt Company.

According to Gebhardtsbauer, retirement income policy will be a top priority. "Congress needs to be educated away from revenue-driven quick fixes," he said. "My experience at Mercer has refreshed my concerns for the needs of actuaries and pension plan sponsors. My private-sector experience has increased my desire to simplify the rules that are hurting the private pension system."

Long active in professional activities, Gebhardtsbauer is currently chairperson of the Academy's Pension Committee and its Tax Reform Task Force. For the Society of Actuaries, he has chaired the Pension Section Council and Committee on Pension Research. Gebhardtsbauer is also a member of the American Society of Pension Actuaries and author of the EA-2 exam study note on pension plan terminations.

Gebhardtsbauer also paid tribute to his predecessor. "As the first senior pension fellow, Bob Heitzman established the foundation for a successful program. His work on tax reform will be especially useful in the upcoming debate on that issue."

Gebhardtsbauer emphasized that his tenure at Mercer was a happy one, but the "opportunity to serve the profession—and the public—through the Academy was too good to pass up. I'm excited by the possibilities and look forward to hearing the concerns of all actuaries."

Gebhardtsbauer was chosen after a month-long selection process. Academy Pension Vice President Vince Amoroso said, "Our selection committee considered several impressive candidates for the senior pension fellowship. However, Ron's experience in Washington and the private sector gives him the perfect background to strengthen the profession's policy role."

Academy Crafts Simplified Health Solvency Formula

Protecting the consumer by maintaining the solvency of health care delivery organizations is the ultimate goal of the Academy Health Organizations Risk Based Capital (HORBC) Simplification Task Force. On March 24 the task force presented a preliminary report on its findings to the National Association of Insurance Commissioners (NAIC) HORBC Working Group at the NAIC meeting in Detroit. The task force's 4-month effort was undertaken in response to an NAIC request to simplify the HORBC formula prepared by the original Academy HORBC Task Force in December 1994.

The NAIC requested that the Academy task force reduce the complexity of the original formula while maintaining its sensitivity to various health risks. The regulators also requested that the formula focus on available data that can be audited by company management and regulators.

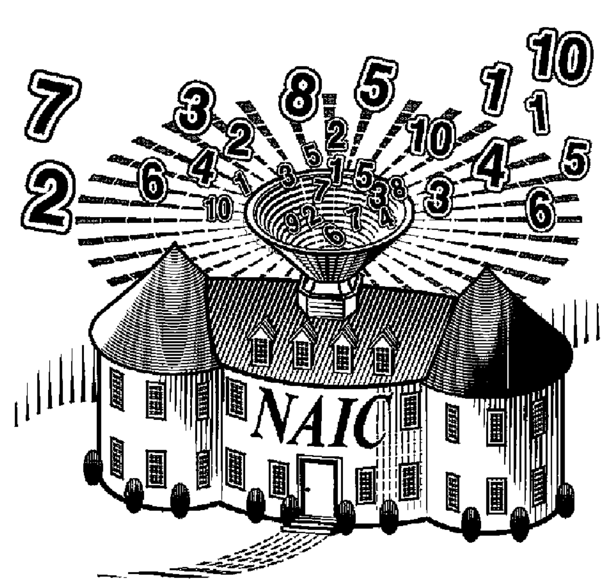


Illustration by Stuart Armstrong

A task force subcommittee chaired by Donna Novak reviewed the many annual statement blanks used by health carriers to determine the information currently available to support the original HORBC formula. The subcommittee found that no such information was available. This set the stage for consideration of formula simplifications.

The most general simplification changed the formula almost entirely to reflect premiums rather than claims, covered lives, and RBC itself. Other simplifications combined formula elements, while others reduced the number of RBC levels for a particular formula element.

These simplifications were then tested to determine their impact on RBC relative to the original HORBC formula. The testing subcommittee, chaired by Darrell Knapp, reported the sensitivity test results to the full task force, which then determined which simplifications should be recommended to the NAIC.

The Academy task force also is addressing a related NAIC request for information on the structure of health care delivery assets used by HMOs and others health coverage providers. Additionally, the task is undertaking a preliminary study of the C-1 risk associated with these assets.

A summary of the proposed HORBC modifications and the status of other work was included in the preliminary report accepted by the NAIC HORBC Working Group. The task force has now shifted its focus to suggesting changes to the insurance blanks to provide needed information for the calculation of HORBC.

With the acceptance of the proposed HORBC simplifications and insurance blank changes, the task force continues to work on instructions and spreadsheets for use in calculation of HORBC. It also continues to develop information and issues associated with health care delivery assets. Finally, the task force is analyzing the relative RBC levels produced by the simplified HORBC formula to assist the NAIC in setting levels for all types of health coverage providers.

— PETER PERKINS

Perkins is the chairperson of the Academy HORBC Simplification Task Force. *For more on the Academy's risk-based capital work for the NAIC, see page 2.*

IN BRIEF

Academy MSA Comments

Medical savings accounts (MSAs) would introduce further adverse selection to the U.S. health insurance system, Academy MSA Work Group Chairperson Ed Hustead told a Cato Institute forum on April 11.

Ed Hustead at April 11 Cato Institute policy forum

Hustead reiterated the conclusions of a 1995 Academy study that found MSAs would attract healthy individuals, leaving older, less healthy people to traditional insurance plans. However, the Academy study also found that MSAs would not immediately capture significant market share, thus minimizing any negative effects. Hustead emphasized that the Academy neither supports nor opposes the MSA concept.

MSAs are back in the news because the House of Representatives has tied an MSA provision onto the Kassebaum-Kennedy health insurance bill. A similar attempt by Majority Leader Bob Dole failed in the Senate, but Dole has vowed to include MSAs in the final bill due to emerge this month from conference committee.

The Cato Institute is a libertarian think tank with important links to Republican congressional leaders. Hustead's participation was part of a broad Academy effort to include the actuarial perspective in the Washington policy debate.

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Risk Classification Important, NAIC Told

An NAIC white paper on genetic testing should clearly state the need for risk classification, an Academy group has told the NAIC Genetic Testing Task Force. The Academy comments came in a letter from David Christianson, chairperson of the Academy task force on genetic testing issues.

Genetic testing is rapidly becoming a key regulatory issue, as lawmakers in several states consider restrictions on insurers' use of test results. The NAIC task force is preparing its white paper for regulators as a guide to the issue's complexities.

"Risk classification is a critical element for any private voluntary insurance system," wrote Christianson. "It not only protects against adverse selection; it also promotes equity among consumers." Christianson also emphasized that adverse selection can threaten the financial soundness of insurers and that restraints on risk classification "should be carefully weighed, considering the potential ramifications for the equilibrium and viability of the insurance market."

Utah Deputy Insurance Commissioner Dixon Larkin, chairperson of the NAIC task force, publicly thanked the Academy for its comments at the March NAIC meeting, where several Academy suggestions were incorporated into the draft white paper. Larkin also invited the Academy to submit further comments before the final document is presented in June.

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Actuaries' Retirement Views

Actuaries believe that Social Security will diminish as a source of retiree income over the next 20 years, according to a recently completed survey of Academy members. Social Security currently provides 41% of retiree household income in the United Sates; the surveyed actuaries expect a drop to 27% by 2016. Medicare's health care costs also are expected to slip from 48% to 42%, according to the survey.

When asked about the financial prospects of future retirees, 57% said they expected less financial security for tomorrow's seniors. Actuaries themselves shouldn't have it so bad, however: The survey population reported saving an average 16% of income for retirement, significantly higher than the 3.5% national average.

The retirement questions were part of a comprehensive survey of actuaries conducted for the Academy by Wirthlin Worldwide, a nationally known opinion research firm. Results of the entire survey, which focuses on actuaries' attitudes toward the Academy and its services, will be available later this month.

The retirement responses were released to the public as part of the profession's *Forecast 2000* program. Academy Executive Director Wilson Wyatt said, "Actuaries are recognized experts on retirement issues, and their opinions should spur debate on the future of public and private retirement income programs."

NAIC Requests Further RBC Aid

NAIC Risk-Based Capital (RBC) Task Force Chair Vincent Laurenzano has requested Academy assistance in quantifying the risk of illiquidity in RBC formulas for life, property/casualty, and health organizations. All three formulas originally were drafted with Academy support.

In a March 25 letter to the Academy, Laurenzano noted the importance of consistency among formulas for all lines of insurance. He underscored the need to blend the HORBC formula in to the existing formulas and cited the liquidity challenge posed by nontraditional health organizations that own health care delivery assets such as hospitals.

Academy Life RBC Task Force Chairperson Cande Olsen discusses her group's report with Illinois regulator Larry Gorski of the NAIC Life RBC Working Group.

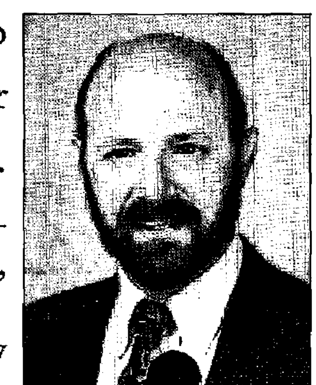
In response to the NAIC request, Peter Perkins, Cande Olsen, and Fred Kist—chairpersons respectively of the Academy Health, Life, and Property/Casualty Task Forces—will form a cross-disciplinary group to study possible Academy action on the liquidity issue.

In other RBC news: At the March NAIC meeting in Detroit, the Academy Life Risk-Based Capital Task Force presented its findings on mortgage factors, separate account surplus, C-3 risk, and negative values. The Academy group also agreed to review the life RBC formula in light of concerns about variable life and annuity contracts.

FROM A GUEST PRESIDENT — SAM GUTTERMAN

A Forward-Looking Profession

In a recent *BestWeek* article ("Note to Disability Insurers: More Forest, Please; Fewer Trees," Life/Health edition, April 1), Eric N. Berg and J. Paul Newsome describe actuaries as "trained to work with rearview mirrors," using "historical claims experience, grossed up by expected inflation to project claims .. [and] backward-looking, numbers-oriented thinking." We stand accused of being oblivious to qualitative, non-linear, or other strategically important trends that affect the businesses we evaluate.



Sam Gutterman

Although not totally negative about actuaries, the article describes us as traditional narrow-minded thinkers, influenced only by a retrospective view of our environment and not cognizant of more significant aspects. The authors recommend that "sociologists, demographers, and other people who ponder the future of . . . society at large" should be hired by insurance companies in place of some of their actuaries.

Is this bleak, narrow view correct? I don't believe so. In fact, I couldn't disagree more. In a broad range of insurance and financial businesses, actuaries remain the experts best equipped to provide a comprehensive view of future risks.

Actuaries own a broad set of risk assessment skills that enable us to analyze historical evidence for trends, as well as focus on sources of future trends. Actuaries also keep abreast of significant developments in related fields, and synthesize and apply that knowledge to insurance situations.

We have been schooled in the recognition of environmental trends, which reflect the significant contributions of experts in related fields. The aim of our broad-based education system is to arm us with a broad set of risk assessment skills. Although our current initial exams emphasize the quantitative aspects of our science, later exams and continuing education teach us to combine science and art through professional and practical judgment. Judgment must be made in the context of knowledge of the environment in which we make our decisions and recommendations.

I am optimistic that our decision-making capabilities will be further enhanced by the results of the current Society of Actuaries/Casualty Actuarial Society basic education redesign effort.

Our core skills include building and applying mathematical models. Significant judgment is involved both in selecting and constructing these models. Historical data are a significant component in building models. However, just as important is the assessment of the risks associated with each situation. In the current application of our science, there has been a trend to apply stochastic methods, which can significantly improve the value of our modes.

However, just because we have built in a stochastic element doesn't mean that we have completed our work. In fact, developing the underlying assumptions used in our models often is the most difficult aspect of model building, and the aspect that we must be able to defend. In the *BestWeek* article's case of disability insurance, actuaries were aware of the trends that led to increased claims among doctors. Unfortunately, companies have not always acted in accordance with their actuaries' findings.

Two challenges face us: to make sure we deliver valuable products and services and to improve the communication of our findings. If we emphasize only compliance, the natural tendency is to concentrate on the past. We must emphasize value to our clients and to the public. Although we cannot afford to ignore the past, actuaries must continue to focus on the future and clearly communicate the results and risks associated with our conclusions.

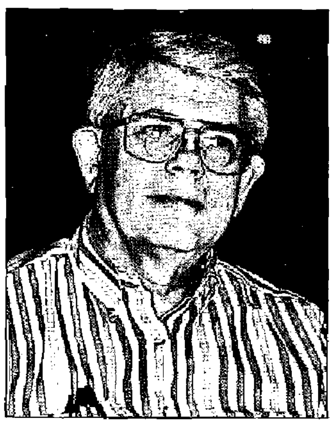
Why aren't the authors of the *BestWeek* article aware of actuaries' forward-looking skills? We must continue our profession-wide information effort. It will be a sign of communications success if we do not see this type of article in the future.

—GUTTERMAN IS PRESIDENT OF THE SOCIETY OF ACTUARIES.

An edited version of this editorial served as the actuarial profession's reply to the BestWeek *article*

Actuarial Reporting Change at SSA

As a result of recent legislation, the chief actuary of the Social Security Administration (SSA) now reports directly to the SSA commissioner. Before the enactment of the Senior Citizens' Right-to-Work Act in March, the chief actuary reported to the deputy commissioner for programs, policy, evaluation, and communications.



SSA's Harry Ballantyne: "Reporting directly to the commissioner will make it easier to get actuarial analysis to the ultimate decision makers in the agency."

Under the new law, the chief actuary will be appointed directly by the commissioner and will serve in direct line of authority to the commissioner, and may be removed only for cause. It also provides that the chief actuary be compensated at the highest rate of basic pay for the federal government's senior executive service.

The change signifies the high regard that Congress and the administration hold for the chief actuary's office in assessing the financial condition of the Social Security program and in developing actuarial estimates of the financial effects of potential legislative and administrative changes in the program.

This role had been emphasized previously in the 1994 House-Senate Conference Report on the bill that established the Social Security Administration as an independent agency. The conference report expressed the view that the Office of the Actuary played a unique role within the agency because it serves both the administration and Congress. It further recognized that, while the conferees expected that the chief actuary would report to the commissioner, the office often must work with the committees of jurisdiction in the development of legislation.

The new legislation fulfills the 1994 conferees' expectation that the Office of the Actuary be permitted to function with a high degree of independence and professionalism in an independent Social Security Administration.

—Harry Ballantyne
Ballantyne has served as chief actuary of the Social Security Administration since 1981.

Actuary in action. Steve Goss, Social Security Administration deputy chief actuary, performs still more calculations at the final meeting of the Social Security Advisory Council on April 13. At the meeting, Goss presented statistical material for the council's report, but the council proved a demanding client, with several members requesting further calculations in support of the council's three minority reports. On one issue the council members were unanimous: praise for Goss's professionalism. (Goss is a member of both the Academy Social Insurance Committee and the Society of Actuaries Social Security Committee.)

Revamping Social Security:
'The Key Is to Act Now'

Marc Twinney, former director of pensions at Ford Motor Company, is the only actuary to serve on the Advisory Council on Social Security, which is due to release its final report this month. Instead of a single set of recommendations, the council will issue three minority reports, all of which endorse some form of Social Security privatization. The council's findings will be submitted to Congress and already have become the centerpiece of the policy debate on Social Security's future. Twinney, in Washington for the Advisory Council's wrap-up meeting on April 13, met with the *Update's* managing editor to discuss the council's work.

Social Security was once a sacred cow. Why did proposals to introduce privatization find such favor with the Advisory Council?

The council looked at all the research: The current investment set-up is not a good buy.

The return the current program earns is in the growth of real wages, which is at about 1% a year. If you look at the capital markets, the real return on bonds is 2%, and stocks are at 6% or 7%. So a system funded at least partially in the capital markets would improve returns.

In your judgment, what is the fundamental problem?

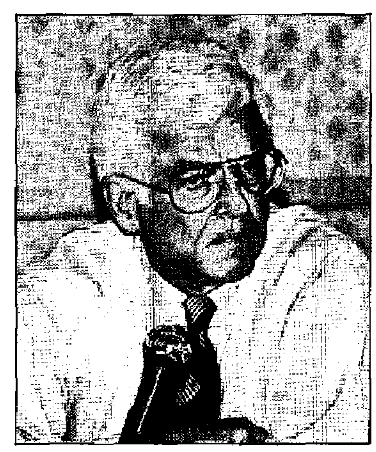
Quite simply, over the long term the Social Security revenue and benefit streams are out of balance. There are three contributing factors to the deficit: The low birth rate, which looks like a permanent phenomenon, offset somewhat by immigration. Greater life expectancy, which is good news, and which should continue to improve because of better health habits. And finally, that meager 1% annual wage growth.

How difficult will it be to bring the program into balance?

In theory, it should be very easy to do: make a 25% adjustment over 75 years. Any actuary in the United States could pull that off. However there are political factors to consider. Some form of sacrifice will be necessary to reduce the long-term deficit, and calling for sacrifice isn't easy under our democratic system. The key is to act now—postponing action means that drastic benefit reductions or tax increases will be necessary later.

What is your position in the council debate?

I support a position between the two extremes of heavy reliance on individual accounts and investing the trust fund in the private sector. All three proposals maintain excellent social adequacy for the lowest income groups, which is extremely important for the country.



Marc Twinney

Why not just invest the trust fund in common stocks?

I don't see that as very likely. Government ownership of large blocks of common stock could lead to several problems—government confrontation with corporate America, for instance. The government could be tempted to use its clout to influence corporate policies on a variety of issues according to the political climate. Some propose giving nonvoting status to government-controlled stock, but that could be tricky for corporate governance. Taking a huge number of shares out of play could lead to greater management influence. Finally, the sheer concentration in the hands of a single entity would have serious market implications.

Your proposal puts a portion of Social Security revenue into individual asset accounts to be managed by each worker. How can we be sure that investors make the right choices to provide themselves with adequate retirement income?

Education will be essential. Eighty-five percent of investment performance is determined by asset mix and 15% by selecting specific stocks. The wisest long-term investment policy is to find the right mix and stick with it. We'll have to get that basic story over to people.

We must encourage individuals to include common stocks in their asset mix. This would increase their own benefits and should have the added effect of creating more capital and growth for the economy.

What reaction do you expect to the council report?

Our mission was to set off a lively debate, which I expect we'll do. The council has considered very thoroughly all the major options for solving Social Security's problems.

Why did the council agree to disagree and issue three minority opinions?

Well, we're not cutting up an expanding pie, but rather doling out sacrifices, and there are honest disagreements among the council members on how to best do that.

But it's important that we act, and act promptly. We can doom the United States to a less efficient economy if we make the wrong choices about Social Security now. Our emerging competitors in the world economy, the developing countries, will not be carrying the burden of an inefficient retirement system. The stakes are high in terms of global competitiveness.

What role can actuaries play in the debate?

There is a huge need for education—for instance in helping people understand that age changes should be part of the solution. Increasing the retirement age should not be seen as a negative thing. Each age cohort is living longer than the one before and is also healthier. People older than 65 represent a tremendous asset to our society, and most want to remain productive.

The actuarial profession could do specific research on how best to use this population of healthy older people.

CPI Changes, Stochastic Analysis for SS

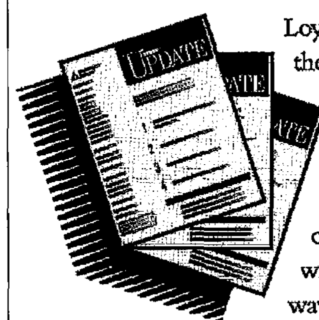
A more accurate consumer price index (CPI) could reduce reported inflation and increase measured real wage rates, Academy member Howard Young told the Senate Finance Committee on March 25. Young, chairman of the Technical Panel on Assumptions and Methods of the Advisory Council on Social Security, stated that the method of developing a more accurate CPI to adjust Social Security benefits was superior to directly modifying the benefit formula, which would leave beneficiaries more vulnerable to inflation. Under federal law, Social Security benefits are tied directly to changes in the CPI.

Young said that the panel reviewed the assumptions used in the 1995 Social Security Trustees' Report and concluded that their overall effect is reasonable.

Young's technical panel also recommended gradual implementation of stochastic analysis procedures to evaluate the uncertainty of projections for Social Security. Uncertainty cannot be avoided, but the use of stochastic techniques could help determine assumptions, Young told the Senate committee. The panel also recommended that periodic actuarial studies be used to review those techniques and develop effective methods for communicating the results to elected officials.

"Deciding which past experience is most relevant for projecting the future will remain important to the Social Security program," said Young. The Advisory Council's report is now slated for release later this month. (See interview, page 3.)

Store Your *Update*



Loyal readers who save every issue of the *Actuarial Update* have pointed out that the redesigned format makes notebook stortage difficult. To solve the problem, specially designed slipcases that will fit on your office shelf are included with this month's mailing. By the way, the *Update* was honored this month by a Society of National Association Publications award in the most improved newsletter category.

NEWS FROM THE HILL

Academy in Hill Health Care Debate

An Academy health care cost analysis was at the center of congressional debate in April. At issue: a proposal to require $10 million lifetime benefit maximums for group policyholders. The proposal gained the spotlight through the lobbying of actor Christopher Reeve, the movie Superman who was left paralyzed by a 1995 accident.

Sen. Paul Simon (D-Ill.) points to statistics from the Academy cost analysis at an April 17 Capitol Hill briefing on the $10 million lifetime limit proposal. Amendment sponsor Sen. Jim Jeffords (R-Vt.) is at right.

The plan was sponsored by Sen. Jim Jeffords (R-Vt.), who offered it as an amendment to the Kassebaum-Kennedy health insurance bill. To prepare for the debate, Jeffords once again turned to the Academy with specific questions about the proposal's cost impact; Academy member Harry Sutton had commented on an earlier version of the amendment last August (see March *Update*).

In an April 12 letter to Jeffords's staff, Sutton stated that the cost of the $10 million limit would vary significantly depending on a plan's current limit. Plans with $50,000 limits would experience premium increases of 17%, Sutton estimated. Plans with $500,000 limits generally would see increases of less than one-half percent. Employers could avoid premium increases by increasing deductibles; $500,000 maximum plans would have to raise deductibles by $15 to offset the extra cost, according to Sutton.

These relatively minor increases in direct costs are balanced in Sutton's analysis by possible long-range increases in health care inflation, spurred by more expensive treatment protocols, and reduced availability of employer-sponsored health insurance for retirees, whose limits are often lower than those for active workers. The full Senate defeated the Jeffords amendment in a 57–42 vote April 18.

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UPDATE

ENCLOSURES

In Search Of ▪ 1995 ASB Annual Report ▪ ASB Boxscore ▪ Update Slipcases ▪ Enrolled Actuaries Meeting Cassette Order Forms