THE ACTUARIAL
UPDATE
VOLUME 27 ▪ NUMBER 4 AMERICAN ACADEMY OF ACTUARIES APRIL 1998

Actuaries Discuss Social Security with President Clinton and Republican Leaders

The Academy stretched its role in the Social Security debate well beyond Washington on March 21 when actuaries joined President Clinton and a Republican congressional leader in a 10 city teleconference on the program's future. The Academy participated at the request of forum sponsors, the Pew Charitable Trusts and Americans Discuss Social Security, a nonpartisan group that encourages grassroots debate on retirement issues.

Asked to serve as an independent resource, the Academy responded by recruiting actuaries to participate in the debate in all 10 cities. At the same time, Senior Pension Fellow Ron Gebhardtsbauer joined President Clinton in Washington as an adviser for the conference. Ken Apfel, commissioner of the Social Security Administration, and Rep. Nick Smith (R-Mich.) also participated in the event, which generated national media attention and was reported on CNN and NBC's "Today Show."

Senior Pension Fellow Ron Gebhardtsbauer and President Bill Clinton, seen here in still photos taken from videotape, participated in the March 21 national town meeting on Social Security. Academy members in ten cities served as technical resources for the public event.

In his remarks, the president urges immediate action to shore up Social Security in an equitable fashion. "We should act as soon and responsibly in ways that will not unfairly burden any generation," he said. "Social Security has been considered political dynamite, but it's worse dynamite to walk away from the problem when we can solve it with modest and responsible steps." As part of any solution, the government should encourage Americans to plan for retirement and make saving for retirement more attractive, the president said.

Swift action is also cheaper, Gebhardtsbauer noted. "A solution will be twice as difficult if we wait until 2029 when the trust funds are exhausted," he said. "At that time we would have to increase taxes by 4.5 percent of payroll," he said. A 2.2 percent increase in payroll taxes would restore the program to solvency if enacted immediately.

Social Security Commissioner Ken Apfel praised the town meeting format, saying "Social Security is too important to be decided in think tanks in Washington." However, citizen participants in the ten cities were split in their analysis of both the problem and the solutions. Academy Pension Vice President Ken Steiner said, "The meeting is a clear indication of the need for more public education." A participant in the Boston meeting, Steiner helped to outline the basic issues and give structure to the discussion.

The other actuarial participants were David Adams, Minneapolis; Kent Bartell, Detroit; Elinor Bowman, Tallahassee; Jeff Bridges, Boise; Don Fuerst, Denver; Peter Neuwirth, San Francisco; Herbert Petterson, Lexington, Ky.; Bruce Schobel, Albuquerque; and Eric Stallard, Winston-Salem.

In Washington, Gebhardtsbauer stepped in at the request of the moderator to respond to more than a dozen questions of fact about Social Security. Rep. Smith, who represented the Republican congressional majority, asked if any benefits could be paid out of the current system in the years following 2029. In that year, without modification to the program, payroll taxes would be enough to pay for only 75 percent of promised benefits. By 2075, Gebhardtsbauer told the congressman, that figure would decrease only slightly, to 69 percent.

Other question topics included the operation of the Social Security trust funds, the effect of Social Security on the federal budget, and the contribution status of members of Congress. On this last point, Gebhardtsbauer informed the audience that Congress members have contributed to the system since 1983. He added that mandating coverage of all new state and local government workers in the program would solve only 10–15 percent of the financial shortfall.

After the event, forum organizers praised Gebhardtsbauer for his invaluable assistance, and other attendees, including representatives of groups such as the American Association of Retired Persons, expressed appreciation for the actuaries' ability to answer tough technical questions. Schobel, who serves on the board of Americans Discuss Social Security, said, "It was great to get ordinary people involved in the debate. Although the level of analysis unfortunately remains rather superficial, such forums help the American public become better informed about the real problems and possible solutions. The forum also boosted the profession's visibility; for many of the participants, the meeting was the first occasion to glimpse actuarial expertise."

Academy Executive Director Wilson Wyatt said, "The Social Security forum performed an important public service, and the Academy is pleased to have been invited to participate. In addition, such events showcase the importance of the actuarial profession's role in social insurance issues. The Academy members who gave their time and talent to the event deserve our thanks."

The nationwide forum builds on past Academy public education activities on Social Security. In the past 18 months, Gebhardtsbauer has spoken at a series of coast-to-coast town hall meetings with members of Congress, including Sens. John Warner (R-Va.) and Robert Kerrey (D-Neb.); and Reps. Tom Barrett (D-Wisc.), Elizabeth Furse (D-Ore.), Jim Kolbe (R-Ariz.), Mark Sanford (R-S.C.), and Charles Stenholm (D-Tex.). In addition, the Academy Social Insurance Committee has issued a widely distributed monograph that lays out options for both Social Security and Medicare, as well as issue briefs on aspects of privatization, raising the retirement age, using a means test, and changing the benefit formula. (For more on the Academy's Social Security effort, see page 3.)

IN BRIEF

No Poorhouse for Mom Is a Benefit

Social Security's rate of return should not be measured in purely monetary terms, Academy member David Langer told the *Wall Street Journal* in a February 18 letter to the editor. Langer was responding to a *Journal* opinion piece by Alan Murray that criticized Social Security as a bad investment deal for younger Americans. A broader view is required, according to Langer, to see the full intergenerational benefit of the national social insurance program.

If a young married couple "pays $140,000 in Social Security taxes in the next 35 years, but Social Security spares them having to contribute say $8,000 a year to support their parents . . . they will have a net profit when they reach 65" and begin to receive their own benefits. "The potential return for many workers can thus be much greater that the 1.4 percent or 5 percent reported by Mr. Murray. Langer, a pension consultant in New York City, has often written on Social Security for the Academy's magazine, *Contingencies*.

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EAs Focus on Professionalism

"My mission is to pump you up on standards and on making the profession stronger," Academy Pension Vice President Ken Steiner told an audience of more than 1,500 at the March 23 general session of the 1998 Enrolled Actuaries Meeting in Washington, D.C. The world's largest gathering of pension actuaries, the annual meeting is cosponsored by the Academy, Conference of Consulting Actuaries, and Society of Actuaries.

Ken Steiner

Steiner offered an overview of professional standards that apply to pension actuaries. The purpose of standards is to codify generally accepted practice and to "raise the bar" by outlining higher standards where necessary.

He also detailed the "whys" of standards: Standards of practice enable actuaries to be self-regulating; educate actuaries; enhance the profession's reputation; and establish reasonable rules before possibly unreasonable rules are established by others.

"Our process offers an opportunity for all actuaries to participate in formulating standards by reading and commenting on exposure drafts. This is your profession; play an active part to keep it strong and healthy."

Also at the session, consulting actuary Ethan Kra discussed "reining in cowboy actuaries," practitioners who routinely skirt the limits of sound professional practice. He concluded his remarks with three hypothetical cases in which a pension actuary faced the dilemma of choosing assumptions that might be unrealistic but would allow employers to increase pension benefits. Should the actuary choose to be a strict constructionist if the result is less money for the workers? To what extent may the pension actuary manipulate assumptions to minimize PBGC premiums?

Also participating in the session were former Academy Vice President Vince Amoroso, David Gustafson of the Pension Benefit Guaranty Corporation, and consulting actuary Robert Schramm .

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Standard in the News

A proposed actuarial standard of practice on allocation of retirement benefits in domestic relations actions was analyzed in the February 18 edition of the Bureau of National Affairs (BNA) *Daily Report for Executives*. Approved for exposure at the December meeting of the Actuarial Standards Board (ASB), *Retirement Plan Benefits in Domestic Relations Actions* was developed by the ASB Pension Committee at the request of the Actuarial Board for Counseling and Discipline (ABCD). According to the BNA report, a number of cases involving actuaries who work on retirement issues in domestic relations actions have been referred to the ABCD. The BNA report summarized standard provisions on conflict-of-interest disclosure, data review, and objectivity of actuarial valuations. The BNA daily provides in-depth coverage of significant legislative and regulatory actions to a readership of policy makers. The article reflects growing awareness of actuarial professionalism among the users of actuarial services. Comment deadline for the draft standard is June 1.

Our Slip Is Showing

A production error caused the byline of last month's page-one story to slip right off the page. "Actuaries Help Shape World Pension Standard" was written by Dennis Polisner, Academy representative on the subcommittee of the International Forum of Actuarial Associations that helped shape the recent international standard on pension accounting.

FROM A GUEST PRESIDENT — MAVIS A. WALTERS

Putting the Profession First

Mavis Walters

With five separate organizations, actuaries in the United States have organized themselves in a unique fashion. Our profession's effectiveness depends on good working relationships among those organizations. I'm happy to report that the relationship between the profession's learned societies, the Casualty Actuarial Society and Society of Actuaries, has never been stronger.

Some may remember that this was not the case less than one year ago. In the spring of 1997, there were a series of events which led to a very serious breakdown in the relationship between these two professional societies. In retrospect, I believe it is fair to say that while no harm was intended in any single instance, the cumulative effect left some in both societies, including some in leadership positions, with a sense of outrage and distrust. Some CAS members believed the Society of Actuaries was embarked on a campaign to take over the CAS. And SOA members interpreted CAS actions as insulting and demeaning.

Thankfully, what followed from all of this were some very frank discussions between the then presidents and president-elects: Dave Holland and Anna Rappaport of the SOA, Bob Anker and me for the CAS. In addition, invitations were extended and accepted for each of us to attend board meetings of the other organization. Those discussions and the personal relationships among the four of us, I believe were critical to putting the controversy behind us.

We have all learned lessons from last year's misunderstandings. Those of us in the CAS leadership have come to recognize that a substantial minority of CAS members hold deep suspicions about the SOA and its aims vis à vis the casualty actuarial profession. CAS members identify strongly with their organization and are fiercely loyal. This member sentiment serves the profession well because it translates into dedicated involvement in CAS activities. We cannot take the views of our members for granted and must keep in mind the diversity of opinion among us.

I think the underlying concern of casualty actuaries with respect to the SOA dates back to a time when the CAS was a much smaller and less well known organization. Casualty actuaries were not always treated as equals by actuaries in other practice areas. Our examinations and training were not always respected, and as a consequence our organization developed a somewhat defensive attitude toward the SOA. Although this situation has changed dramatically over the past 20 years, some CAS members have long memories. Leaders of both organizations must understand this legacy of sensitivity when dealing with interorganizational problems.

Maintaining good relationships, whether between individuals or organizations, requires continual effort. From the outset, both parties must be convinced that the effort is worthwhile. Clearly the SOA and CAS both make important contributions and must work together for the good of the profession. The demonstrated commitment of our leadership to continue to improve our mutual understanding is a good sign for the future. SOA President Anna Rappaport and I communicate directly and frequently through e-mail and telephone conversations. President-elects Howard Bolnick of the SOA and Steve Lehmann of the CAS also maintain close ties and recently have worked together on the joint academic symposium.

To make permanent this atmosphere of cooperation beyond the current leadership, it would be helpful to continue these regular meetings of our societies' leaders with the boards of other organizations. Such regular contact would help us allay fears and address differences promptly. In addition, regular communication among the actuarial leadership will help dispel any problems that may arise at the staff level. We also need more cooperative efforts across practice lines to expand the horizons of the actuarial profession. Joint projects in education, research, and communications through the profession's Forecast 2000 program can be helpful in this regard also.

The real threat to our profession's future does not come from other actuaries, but from competing groups of specialists who practice in areas where actuarial expertise can and should contribute. Too often, statisticians, demographers, economists and others never think of consulting with members of our profession. These groups continue to move into emerging areas of specialized practice where actuaries should have a role. The education, training, and experience that all actuaries possess equips us to solve many problems. The same talents that we use in our traditional assignments can be used in many different areas.

Actuaries must ensure that the potential users of actuarial services understand the importance of our unique skills. We must be prepared to prevent the erosion of our responsibilities in both the private and public sectors. As the one organization for the entire profession, the Academy is fulfilling quite well its mission of ensuring actuarial involvement in public-policy decision making. The Academy also serves as an important neutral forum for all actuaries, and service on the Academy Board of Directors permits the leaders of all our organizations to work together for common goals. In this way, the Academy contributes to healthy cooperation within the profession.

I believe, if we were starting from scratch, U.S. actuaries would not choose to organize themselves into five separate organizations. However, with more than a century of history behind us, it would be counterproductive to attempt a major reorganization of governance. Actuaries of all stripes should be proud of our separate achievements and committed to our common goals. I hope and expect that the SOA and CAS will continue to work together harmoniously to strengthen our profession's future.

—WALTERS IS PRESIDENT OF THE CASUALTY ACTUARIAL SOCIETY AND SERVED AS ACADEMY PRESIDENT IN 1990–91.

DAVID G. HARTMAN

Actuaries and Regulators: A Success Story

Insurance operations are becoming increasingly complex, requiring ever more astute and well-trained personnel to perform them. Gone are the days when a simple premium-to-surplus ratio defined capital requirements, or an unadorned combined ratio sufficed to indicate pricing adequacy. Maybe not gone, but also disappearing is the "backroom" actuary, who calculates numbers on a spreadsheet but never ventures into the public arena.

This complexity has led to an intertwining of the roles of actuaries and regulators. State regulators must determine whether a increase is justified, a company's reserves are adequate, or an insurer is undercapitalized. Few regulators have the expertise to answer these questions independently. Rather, regulators are working with actuaries to set appropriate standards and measuring tools to resolve questions that arise.

There are good and growing reasons for actuaries and regulators to interact, and in the past few years I have been fortunate to have worked at the intersection of the actuarial profession and public, as represented by regulators. In particular, the successful outcomes of projects on loss reserves and capital standards illustrate the benefits of increased cooperation between casualty actuaries and regulators.

Estimating property-casualty loss reserve needs, as well as monitoring loss reserve adequacy, is a complex task. To minimize insurer insolvencies, with their consequent harm to policyholders, state regulators must evaluate whether reported reserves

David Hartman

have been properly quantified. Yet the expertise for quantifying these reserves lies with company actuaries, whose interests are not always the same as those of regulators.

In the early 1980s, three distinct groups contributed to what resulted in the *Statement of Actuarial Opinion Regarding Loss and Loss Adjustment Expense Reserves* that must now accompany an insurer's annual statement. An NAIC Blanks Task Force, composed of state regulators, decided on the final wording of the Opinion and of related regulations. In addition, the NAIC Casualty Actuarial (Technical) Task Force (CATF), composed of actuaries working in state insurance departments, developed drafts of the *Opinion* and of the regulations, (and still proposes revisions each year). Third, the CATF Actuarial Advisory Committee had developed the original drafts and recommendations that the CATF perfected into drafts for the NAIC task force. This project was a milestone on the road leading toward increased cooperation between regulators and casualty actuaries.

Capital standards development is an equally critical task for the protection of the public. After all, even if reserves are correctly stated, other unforseen events may undermine the financial solidity of the insurance enterprise. The current minimum capital statutes of most states are often ad hoc requirements that give state regulators insufficient authority to deal with impaired companies.

The NAIC Risk-Based Capital Working Group issued the first draft of new capital requirements early in 1991. This first draft, the early risk-based capital formula, was a rough version, with some pieces entirely missing and others only partially complete.

To assist the NAIC in refining the risk-based capital requirements, several actuaries formed an advisory committee, which subsequently became an Academy task force under my chairmanship. Our role was not adversarial: we were not presenting an industry counterpoint to the NAIC position. Nor were we serving as simple consultants, performing statistical work for which the NAIC lacked the resources. Rather, our role was professional: we brought actuarial expertise to the quantification of risk and the determination of capital standards. Sometimes our conclusions were supportive of the NAIC procedures; sometimes they were critical of them.

But they were well-reasoned and objective actuarial conclusions, distorted as little as possible by the special interests of particular groups. Both the NAIC and the insurance industry valued our judgments, leading to an enormously productive relationship. Whole sections of the risk-based capital formula were added by our committee, and the calibration of parameters of many other sections were changes.

Unfortunately, it has not always been easy for the profession and regulators to work together because negative experience may have prejudiced the relationship. Some may say, "If the NAIC wants it, then it can't be good." Or, "If the industry wants it, there must be a catch." However, public policy issues such as workers' compensation, personal automobile rate levels, and risk classification are areas where actuaries and state regulators often have worked well together.

As the public policy voice for all areas of actuarial practice, the Academy encourages actuaries to work *with* regulators and other public officials, not at cross purposes to them.

Actuaries are not effective when they simply criticize regulators; they add little value when they uncritically support them; but they have great influence when they work independently yet cooperatively with them.

The years since the development of the first risk-based capital formula have seen a remarkable expansion of cooperative activities between regulators and actuaries in health, life, and casualty practice. The Academy, Actuarial Standards Board, and Actuarial Board for Counseling and Discipline continue to nurture these close working relationships by holding regular information-sharing meetings with NAIC leadership. Mutual trust is replacing suspicion, and the professionalism of actuaries is increasingly respected by regulators. Actuarial involvement in developing sound insurance regulation has been a success story for the profession, one we must continue to build upon for the public good and our profession's future.

This article has been adapted with permission from the preface to "Regulation and the Casualty Actuary," a book of readings from the Journal of Insurance Regulation *published by the National Association of Insurance Commissioners.*

—HARTMAN IS FORMER PRESIDENT OF BOTH THE ACADEMY AND CASUALTY ACTUARIAL SOCIETY AND CURRENTLY SERVES AS CHAIRPERSON OF THE ASB.

SOCIAL SECURITY

SUSAN SZOT

Retirement Age May Be Part of Solution

Social Security has been the talk of Capitol Hill since the President's State of the Union address in January. As the issue heats up, government leaders are turning to the Academy for information on solutions to the Social Security problem. The expertise of Ron Gebhardtsbauer, Senior Pension Fellow for the Academy, has been sought by congressional leaders. Gebhardtsbauer was asked to testify before the House Ways and Means Subcommittee on Social Security on February 26. The topic of the hearing was "The Future of Social Security for This Generation and the Next: Raising the Retirement Age." Gebhardtsbauer testified about the possibility of raising the retirement age to 67 and, eventually to 70.

Ron Gebhardtsbauer (left) with Rep. Jim Bunning (R-Ky.), chairman of the House Ways and Means Subcommittee on Social Security.

"Increasing the normal retirement age to 70 would solve about half of Social Security's financial problems," Gebhardtsbauer explained. "Increasing the earliest retirement age would solve another 10 percent of the problem, and indexing the retirement age would make it less likely for the system to go out of balance in the future. However, an increase could also have a negative impact on the social adequacy component of Social Security."

Gebhardtsbauer suggested that seniors over 65 could work part-time and collect part of their Social Security benefits. This proposal would have a threefold benefit: seniors could ease into retirement, a transition to a higher retirement age would be smoother, and it would help employers hire older workers. This phasing in would include a declaration by the senior of intent to go to part time. The declaration would replace the earnings test.

"Under this option people would choose their own retirement age and how to phase in their Social Security benefit rather than be subject to the earnings test," Gebhardtsbauer explained. "It would also bring in more payroll taxes than if the worker completely retired. If Congress chooses this option it should also make it easier for private sector pension plans to pay partial benefits to employees who switch to part-time work."

Rep. Rob Portman (R-Ohio) expressed interest and asked Gebhardtsbauer to elaborate on the idea. Gebhardtsbauer explained that "the declaration could replace the earnings or retirement test and be done in a way that is actuarially neutral to Social Security. But this plan could have disadvantages."

Rep. Jim Bunning (R-Ky.), chairman of the subcommittee, expressed some of his concerns. "[R]aising the retirement age would not be advantageous for those who are unemployed or work in arduous occupations," he noted in his opening statement. "Low-wage workers who have poor health or fewer skills would be adversely affected, as would certain minority groups with shorter life spans."

Gebhardtsbauer also pointed out some of the disadvantages to the plan during his presentation. The increase in retirement age would shift more of the burden onto employers. FICA taxes would be kept down, but employers could face rising benefits costs as their work force ages.

Gebhardtsbauer also noted that in 10 years, labor shortages due to massive retirements of the baby boomers might cause employers to rethink their retirement strategies. Instead of encouraging employees to retire, they might encourage them to stay on at least part time. This could be helped through some modifications of ERISA and the Age Discrimination in Employment Act.

As Congress works to solve the problems of Social Security, the Academy will continue to provide the actuarial expertise necessary for any changes to the Social Security structure. (For more on Academy participation in the Social Security debate, see page 1.)

—SZOT IS EDITORIAL ASSISTANT.

Academy State Health Committee Helps NAIC

The Academy assisted regulators on several technical health insurance issues at the March meeting of the National Association of Insurance Commissioners (NAIC) in Salt Lake City. The Academy State Health Committee coordinated the Academy health work, often in response to requests from the Accident & Health Working Group (AHWG) of the NAIC Life & Health Actuarial Task Force. The AHWG is chaired by Minnesota regulatory actuary Julia Philips, who has replaced New Mexico's Jerry Fickes. State Health Committee Vice Chairperson Donna Novak was the *Update's* correspondent in Salt Lake City and provided the following report.

Minimum Health Reserve Standards

An AHWG work group has completed a model regulation on health insurance reserves, which allows reserves to be determined on a block basis rather than a contract basis. The model regulation conflicts with NAIC codification standards that require reserves to be determined on a contract basis where claims expenses exceed the premium. Contract-based reserving results in increased reserves for community-rated policies and for contracts with deficient premiums, even if carriers have the ability to increase premiums adequately at renewal. The AHWG has asked the Academy to provide appropriate professional guidance to support the regulation. In a letter to State Health Committee Chairperson Peter Perkins, AHWG Chairperson Philips requested that the Academy review existing actuarial standards of practice to determine if revisions are needed to keep the standards in sync with proposed minimum reserve changes.

PSO Solvency

Under the provisions of last year's Balanced Budget Act, the Health Care Financing Administration (HCFA) consulted with the Academy before beginning deliberations on solvency regulations for provider service organizations (PSOs) under Medicare. The Academy also provided comments to the draft report of the HCFA rulemaking committee (see March *Update*) and in a March letter urged the committee to require actuarial certification by a qualified Academy member.

Fred Nepple, an NAIC representative to the federal PSO rulemaking committee, reported on the committee's final solvency standards. Important to note is that PSOs with federal licensing waivers may fall under state policy form, disclosure, and insolvency regulation. Rural PSOs face special challenges, and HCFA is requesting comment on variations to the standards for these entities. Final regulations for PSO solvency will be issued by April 1 and final Medicare Choice regulations by June 1.

Risk-Based Capital

The health risk-based capital model act was approved by an NAIC working group and sent for exposure to the Risk-Based Capital Task Force. Comments are requested no later than June 1. At a meeting of an NAIC working group, Academy representative Burt Jay presented an analysis of recent changes in the risk-based capital formula for health insurers, and Novak discussed the effect of including rate stabilization reserves in the formula. The working group will review proposals to include rate stabilization reserve credits and factors for long-term care in the formula at an April 27–28 interim meeting. Also in April, the NAIC will conduct a survey of managed-care and Blue Cross organizations on the most recent formula iteration. Over the past decade, the Academy has been instrumental in developing RBC formulas, with the original health formula the product of a group led by Health Vice President Bill Bluhm. (See also "A Success Story," page 3.)

The NAIC RBC Task Force is interested in increased capital requirements for the market-valued statutory value of "downstream" insurance subsidiaries. NAIC concern arises from initial public offerings (IPOs) in which the parent firm retains more than 50 percent of voting interest. Due to codified accounting principles, the IPO increases a company's total adjusted capital without an accompanying increase in RBC. RBC working groups from life, casualty, and health practices were asked to review this issue and analyze the effect of proposed changes on their formula. The Academy Joint RBC/Liquidity Task Force provided comments on the initial proposal and will continue to assist the working groups as they proceed.

Dan McCarthy (left) and Bob Likins helped keep the discussion lively as the Academy Committee on Qualifications continued its careful review of member comments on a draft revision of qualification standards at a March 10 meeting in Washington. According to chairperson Likins, the committee received almost 30 comment letters in response to the draft standards. The committee hopes to complete its review this summer and at that time will decide whether to seek more comments via another exposure draft.

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