AUGUST
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THE NEWSMONTHLY OF THE AMERICAN ACADEMY OF ACTUARIES

Actuarial UPDATE

*Pension Disclosure*

# Finding Common Ground with Regulators

BY EDWARD E. BURROWS

THE MASSIVE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT of 2001 signed into law by President Bush on June 7 includes a new pension disclosure requirement. With certain exceptions, pension plan sponsors must notify affected participants of any amendment providing for "a significant reduction in the rate of future benefit accrual." The notice must "allow [participants] to understand the effect of the plan amendment" and must be provided within a reasonable time before the effective date of the amendment. With minor exclusions, the new rule applies to amendments effective on or after the date the act was signed into law.

This requirement didn't come as a surprise to anyone familiar with current developments. The Academy's Pension Practice Council anticipated it many months ago when it asked the Actuarial Standards Board (ASB) to consider developing a projected benefit illustration standard. Many members of the practice council felt that if actuaries were going to have rules regarding disclosure of changes, it would be better to have the profession participate in the rule making.

See **REGULATORS**, Page 4

## Inside



## Star Witness


DARREN KING/MISSOURIAN

Ron Gebhardtsbauer answers questions at the hearing.

RON GEBHARDTSBAUER, THE ACADEMY'S senior pension fellow, was the sole witness at a June 18 field hearing of the House Ways and Means Social Security Subcommittee. More than 300 people attended the Columbia, Mo., session, where Gebhardtsbauer served as nonpartisan expert and discussion leader.

In his presentation, Gebhardtsbauer explained the financial challenges facing Social Security and outlined 10 frequently mentioned solutions. The audience divided into small groups to decide which solutions they preferred. Among the most frequently mentioned options were increasing the retirement age, eliminating the cap on taxable wages, and investing trust fund assets in the stock market.

The hearing also drew representatives of a coalition opposed to Social Security private accounts, which held a news conference to denounce the individual account approach favored by Subcommittee Chairman Clay Shaw (R-Fla.). Rep. Kenny Hulshof (R-Mo.), who represents Columbia, was the other Ways and Means member present. No Democratic members of the subcommittee attended. The hearing attracted coverage from the Associated Press, the *St. Louis Post-Dispatch*, and local news media.

Slides from Gebhardtsbauer's presentation are available online at **www.actuary.org/news.htm#starwitness.**

The Actuarial Update

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# Risky Business

BY FRED KIST

CATASTROPHES REPRESENT A SIGNIFICANT loss potential for property and casualty insurance companies. How do these companies effectively deal with that exposure?

That was the topic of an educational report presented by the Academy's Catastrophe Management Work Group at the summer meeting of the National Association of Insurance Commissioners (NAIC) June 10 in New Orleans. Some 100 people attended the presentation, which was part of the Academy's ongoing effort to provide technical support both to the NAIC and to federal regulators who, in the wake of the passage of the Financial Services Modernization Act, are focusing more on insurance matters. The Academy prepared its primer at the request of the NAIC's Coordination with Federal Regulators Working Group.

From left, Academy work group members Dave LaLonde and Fred Kist with NAIC regulators Arnold Dutcher and Fran O'Connor.

While cautioning that there is no one procedural template that all insurers use, the work group outlined a basic process for catastrophe management including:

- Identifying risk appetite
- Measuring, pricing, and controlling exposure
- Evaluating ability to pay losses.

Actuaries play an active role in many of these processes, the work group said.

In its presentation, the work group stressed that policy-makers need to remember that new laws and regulations sometimes have unintended market consequences.

"Public-policy considerations are integral to a broad-based catastrophe management evaluation," said Mike McCarter, a member of the work group.

Another element regulators need to keep in mind, the report said, is the importance of loss mitigation efforts, such as hurricane shutter credits, in controlling catastrophe exposure. "Industry support of state and local mitigation efforts is key" for such programs to succeed, said work group member Dave Lalonde.

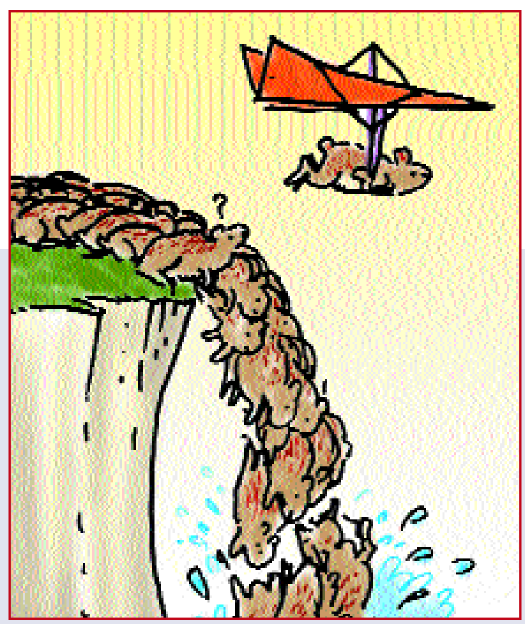
For a copy of the report go to **www.actuary.org/pdf/casualty/catmonograph_june01.pdf.**

**Fred Kist is co-chairperson of the Academy's Catastrophe Management Work Group and a member of the Academy's Casualty Practice Council.**

**UNLIKE LEMMINGS, ACTUARIES CAN CHOOSE TO DO THINGS DIFFERENTLY.**

**In fact, we pride ourselves on it.**

**But remember: the Professional Code of Conduct requires that we be able to justify our actions, even the obvious ones, before we hit the beach.**




JOE SUTLIFF

# Planning Ahead for Long-Term Care


THE DEMOGRAPHIC CHANGES THAT THREATEN the solvency of Social Security and Medicare will also be placing tremendous pressure on public funding of long-term care.

One solution currently under discussion is the development of a tax policy that would offer incentives for buying private long-term care insurance. In a new issue brief, *Federal Tax Incentives for Long-Term Care Insurance: Actuarial Issues and Public Policy Implications*, the Academy's Task Force on Long-Term Care considers the benefits of such a move.

The primary appeal of increased private long-term care insurance is that it could prefund a substantial part of the burden society will shoulder as the baby-boom generation ages, the issue brief says.

But it also has the advantage of shifting more of the funding responsibility for long-term care from the government to the individual. The implications of such policy changes for Medicaid, currently the largest source of funding for long-term care expenses, are significant. To the extent that private long-term care insurance becomes a larger source of nursing facility payments, the issue brief states, the Medicaid system will be able to better target its expenditures to the truly needy, providing better care and avoiding or minimizing funding crises.

Possible tax incentive options discussed in the issue brief include:

- Providing above-the-line income tax deductions and/or tax credits.
- Providing deductions through cafeteria plans and flexible spending accounts.
- Allowing premium payments without penalty from IRA, 401(k), and similar tax-deferred retirement accounts.

Policy-makers will also have to consider strategies to limit losses in tax revenues, the issue brief states. Some of these include:

- Setting a maximum cap for tax incentives.
- Adding income phase-out amounts to target lower-income taxpayers.
- Setting an age cap on tax incentive eligibility.
- Limiting tax incentives for a specific number of years.

The issue brief concludes that while tax incentives might initially appear to create a loss in revenue, big savings in Medicaid spending would even the equation.

Eric Stallard chairs the task force. Other members are Malcolm Cheung, James Glickman, Tim Gustafson, Paul Janus, Walter Liptak, Bartley Munson, Julia Philips, Alwyn Powell, Bruce Stahl, Gordon Trapnell, and Robert Yee.

# On the Move

***Washington*** **— CRAIG HOFFMAN** has been appointed to the IRS Tax-Exempt Advisory Committee. Hoffman is president-elect of the American Society of Pension Actuaries and a member of the Academy's Board of Directors. He is vice president and general counsel of SunGard Corbel in Jacksonville, Fla.

***New York*** **—** New York Life Insurance Co. has promoted **CANDE OLSEN** to senior vice president in charge of corporate services. She was formerly vice president and chief procurement officer. Also **GEORGE SILOS** has been named vice president and actuary in the risk management department. He was formerly corporate vice president and actuary.

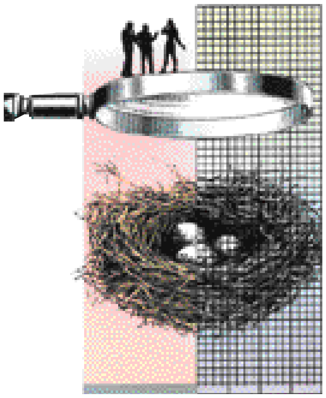
***Toronto*** **— STEVEN MANNIK** has been appointed senior vice president and general manager for Manulife Reinsurance. He was formerly vice president of business development for Manulife Financial.

***West Des Moines, Iowa*** **—** National Travelers Life Co. has promoted **MELVIN RAMBO** to the position of president and chief operating officer. He was also elected to the board of directors. Rambo was formerly vice president for administration and chief actuary. **WILLIAM ODDY** was elected chairman of the board of directors for National Travelers Life Co. He will continue to serve as chief executive officer of FBL Financial Group, Inc.

***New York*** **— TODD BAULT,** an institutional analyst for Sanford C. Bernstein and Co., was featured in a cover story in the June issue of *Best's Review* about his work following major insurers like AIG, Allstate, Chubb Corp., CNA, Hartford, Progressive, and St. Paul Cos.

***Washington*** **— JEFFREY SPEICHER** has joined the Pension Benefit Guaranty Corp. as media relations officer. He was formerly the Academy's assistant director for media relations.

# Regulators continued from Page 1



A year ago, the ASB issued an exposure draft of the requested standard. It drew mixed reviews. Some saw it as a proposal that deserved serious attention and, ultimately, adoption as a final standard. But others saw absolutely no value in the proposal and felt the ASB should remove the entire effort from its agenda.

All of this leaves us at a crossroads. We can stand aside and wait for the regulators to develop their mandatory disclosure rules. Or we can attempt to engage the regulators in a joint effort to develop a set of rules cooperatively.

If we take the latter approach, the current exposure draft is a carefully constructed outline that will serve as an excellent first step in any joint effort. Regulations and the standard could be brought to their final versions concurrently. The regulations could enjoy input from members of the ASB. The standard could enjoy input from the regulators. The regulations could mandate disclosure that is certified by an enrolled actuary. The enrolled actuary would be bound to follow the standard—or justify the deviation.

Before we decide which way to turn, we need to examine, carefully, the reasons for and against a cooperative effort.

Proponents of the cooperative approach offer powerful arguments supporting their position. They see the cooperative approach as a way to improve the quality of disclosure. They believe cooperation will bring credit to the profession, and establish a precedent for cooperation between government and the private sector in other areas of retirement income regulation.

Opponents offer equally powerful arguments against pursuing the effort. They see the approach as one that cannot succeed. They believe any attempt will bring discredit to the profession and alienate our clients.

But proponents and opponents both agree that the issue shouldn't be treated casually. It deserves thoughtful attention by the entire pension actuarial profession. And it deserves prompt attention. Congress instructed the Treasury Department to issue regulations implementing the new requirement within 90 days (see story below). Nobody really expects that fast a response. Nevertheless, if the private sector is going to participate, it must launch an initiative at once.

Before we decide which way to turn, we need to examine, carefully, the reasons for and against a cooperative effort.

In the September issues of *Contingencies* and the *Actuarial Update* there will be point-counterpoint discussions of the arguments for and against pursuing a pension illustration standard. For most pension actuaries, this should be must reading. After reading, register your opinion with the ASB. It's the best way to ensure that your vote is counted.

To read the proposed standard online, go to www.actuary.org/pdf/asb/benefit.pdf.

**Edward E. Burrows is a member of the Academy's Pension Practice Council and Pension Committee and a former member of the ASB.**

# New Pension Law Gets Academy Scrutiny

A DELEGATION FROM THE ACADEMY met with Treasury Department officials in late June to discuss the pension elements of President Bush's new tax cut law. Both the Treasury Department and the Internal Revenue Service are responsible for writing regulations based on the legislation, which passed Congress in late May and was signed into law by Bush on June 7.

Meeting with Bill Sweetnam, benefits tax counsel in the Treasury Department, and Harlan Weller, actuary for the Treasury Department, Academy representatives asked for clarifications of certain portions of the law and described potential problems with implementation.

Attending the meeting were Ethan Kra, vice chair of the Pension Practice Council, Don Segal, chair of the Pension Committee, Carolyn Zimmerman, Pension Committee vice chair, Pension Committee member Adrien La Bombarde, Pension Council member Ken Steiner, Senior Pension Fellow Ron Gebhardtsbauer, and Pension Policy Analyst Bridget Flynn.

# Building Sound Policy

Todd Tuten

TODD TUTEN, THE ACADEMY'S NEW DIRECTOR OF PUBLIC policy, thinks the Academy is an incredible resource for policy-makers.

He should know.

Tuten is a former chief of staff to Rep. Mike Bilirakis (R-Fla.), chairman of the Health Subcommittee of the House Energy and Commerce Committee. In that position, Tuten was responsible for all legislative initiatives under the subcommittee's jurisdiction, including issues related to Medicare, Medicaid, pharmaceuticals, public health, and health insurance. And he liked hearing from actuaries — through monographs, issue briefs, or in briefings — on those issues.

"They would offer information I could use—not telling me what to do, but showing me what the trade-offs were. As a staff member, I found that very helpful," Tuten said in a recent interview with the *Update*.

In his new position, Tuten intends to continue the Academy's efforts to give policy-makers thoughtful, unbiased information on the issues. "Having worked on Capitol Hill, particularly on health care issues, I am acutely aware of the need for sound actuarial data," Tuten said.

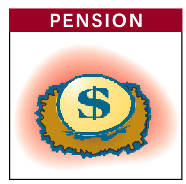
"As good citizens, actuaries need to be involved in building sound policy," Tuten said. And it doesn't hurt, he added, to "maximize every opportunity to underscore the value of the actuarial profession."

Tuten, who received a law degree from Vanderbilt University and was admitted to the Florida bar, didn't anticipate much difficulty making the jump from a highly partisan environment to one that is nonpartisan. "Training as an attorney really teaches you to argue both sides of a question," Tuten said. "So even on Capitol Hill, when I was advocating one position, I could see the point of the other side."

Prior to working as Bilirakis' chief of staff, Tuten served as legislative counsel to the American Public Power Association.

A native Floridian, Tuten graduated from the University of Texas at Austin with a bachelor's degree in government.

# Sagging T-Bond Rates Snag Pension Calculations




THE DECLINE IN 30-YEAR TREASURY BOND interest rates is causing some employers to contemplate terminating their defined benefit (DB) pension plans because of surging funding requirements, the Academy's Pension Practice Council warned in a recent public policy statement.

"For the past decade, 30-year Treasury rates have been around 100 basis points below Moody's composite long-term corporate bond rates. Due to debt reduction, 30-year Treasuries are now about 200 basis points below Moody's," the council noted.

Because there are numerous circumstances where both the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) require using the Treasury bond rates for pension calculations, actuaries are being forced to measure benefit liabilities using the lower rates, the council said.

For example, the Treasury bond rate is used to determine a plan's current liability for funding purposes. For an average pension plan, the reduction of Treasury bond rates in the past couple of years has increased liabilities by about 12 percent. Because the minimum contribution must assume a plan is entirely invested in low-yield Treasuries, minimum contributions can increase from zero to more than twice the annual cost of the plan's total liability, a huge increase for a company's cash flow.

Low rates also mean that many adequately funded plans must nevertheless pay large extra premiums to the Pension Benefit Guaranty Corp.(PBGC), the council said. (They are required by law to use an interest rate equal to 85 percent of 30-year Treasury constant maturities, currently a very low 4.67 percent, when calculating PBGC premiums for a plan's vested benefit liability.)

The low rates also hurt participants in contributory DB plans because the Treasury bond rate is used to project accumulated employee contributions for conversion to an annuity. This is a disadvantage for those who are not vested in their employer-provided benefit because their employee contributions are projected to earn interest at lower rates.

The council has requested its Pension Committee to study and report on alternatives for increasing the discount rates required by law for pension plans. The committee's findings will be released later this year.

To read the council's statement, go to **www.actuary.org/pdf/pension/treasurybonds_071101.pdf.**

FINANCIAL REPORTING

# Insurance Risk: An Introductory Course

IT WAS BACK TO BASICS AGAIN on July 9, as the Academy hosted "Insurance Risk 101" — the second in a series of educational briefings the Academy is holding this summer on Capitol Hill.

In the wake of the Financial Services Modernization Act, Congress has expanded responsibility for insurance regulation. In response, the Academy is stepping up efforts to educate congressional staff and policy-makers on the fundamentals of insurance risk.

"Gramm-Leach-Bliley changed the landscape for the insurance industry and for actuaries," said Pat Teufel, vice chairperson of the Academy's Financial Reporting Council, who moderated the briefing. "No longer is the state insurance department our sole regulator. We need to focus on what Congress is thinking about insurance, and what the Federal Reserve Bank is thinking about insurance, and we need to educate those

Speakers Tim Tongson, Pat Teufel, and Jim Rech

## *Letter* TO THE *Editor*

### Protecting Our Rights

I am writing in response to the articles in the March *Update* about ABCD procedures and bylaws.

First, thanks are due, both to those who give their time to serve on the ABCD and to those who have taken the time and effort to write articles voicing their concerns about current investigation and discipline procedures at the ABCD.

All who were involved in the *Update* discussion appear to have the same worthwhile goal: an effective and just process that simultaneously protects the integrity of our profession and our rights as members. The effectiveness of the ABCD is vital to the actuarial profession's existence.

It's not easy to protect the rights of members being investigated without diminishing the effectiveness of the process. But the constitutional protections we enjoy as American citizens should not be ignored. They were not haphazardly drafted.

Mr. Johansen clearly has unparalleled experience with the ABCD, but his responses to Mr. Levy and Mr. Miller didn't convince me that their concerns were unjustified. Mr. Johansen states, "The analogy to a judicial process is . . . inappropriate." I think the analogy is strong. Even though there is only a "determination, by the actuary's peers, that the actuary did not meet the standards of conduct, practice, and qualification," that determination is completely analogous to a finding of guilt by a jury (also of one's peers) in a criminal court. And as in a criminal court, there is a sentencing. The fact that this is called a recommendation doesn't diminish its impact.

Mr. Johansen's point that public inquiries don't serve our interests is reasonable, as long as the actuary has the opportunity for public review. I was pleased to learn that nothing prevents an actuary from freely and publicly discussing an inquiry into his own conduct.

The limitations on the role of counsel, and other related issues, could create a problem. Mr. Miller's point that indispensable rights guaranteed by the U.S. Constitution aren't being retained in our procedures is worth considering. The questions he poses near the end of his article provide a hint of what could happen should the ABCD become staffed by those lacking objectivity.

The statement that limitations on counsel "have not yet created adverse consequences for members" isn't a legitimate point, since the rules have only been in effect for a couple of years. As actuaries, we should understand the fallacy of assuming that since a loss hasn't happened yet, there's no risk. Without safeguards similar to those in the Constitution, there's virtually no protection for a member other than the board members' integrity and complete lack of bias.

Mr. Levy makes a strong point about the injustice of seating the disciplinary committee chairperson on an appeals panel. One doesn't need to believe that either the ABCD or the appeal panel is "predisposed to punish the actuary," as Mr. Johansen states, in order to be very concerned about whether this would underconstituencies about insurance risk."

Speaking about life insurance, Tim Tongson, chairperson of the Academy's Banking and Financial Services Task Force, discussed different life insurance products, how they are priced, the role of underwriting, and industry shifts as consumer concern about outliving retirement funding eclipses concern about premature death.

Jim Rech, vice chairperson of the task force, spoke about property-casualty insurance, explaining the different lines of business, different ways in which insurance is marketed and sold, and guiding principles for underwriting and covering claims.

From left, Meredith Watts, Jim Rech, Tim Tongson, and Pat Teufel listen to a congressional aide's question.

The luncheon briefing was attended by a select audience that included House Financial Services Committee staff, as well as other House and Senate staff and policy-makers.

The Academy is planning a follow-up briefing, "Insurance 201: How Insurance Is Regulated," to be held later in the year. On Aug. 3, the Academy will host "Pensions 201," which will address the implications of President Bush's tax cut legisation. Later this month, representatives from the Academy's Health and Life Practice councils will combine forces for a Capitol Hill briefing on genetic testing issues.

mine the fairness of the appeals process.

Try to imagine a criminal appeals court in which the bench included the judge from the original trial. Might there be some bias? Independent appeal is essential to the integrity of the process.

Finally, history has shown us that there's really no difference between fact-finding proceedings and prosecutions if someone's career and reputation are destroyed. This is exactly what could be at stake for an actuary who is the subject of an ABCD inquiry.

Safeguarding the rights of actuaries who are investigated will serve our membership well, both now and in the future when others will be doing the investigation and discipline.

*David L. Ruhm*
*Hartford, Conn.*

LARRY JOHANSEN REPLIES:

Mr. Ruhm's letter takes issue with several of the points made in my article on the ABCD published in the March issue of the *Actuarial Update*. Rather than restate those points, I will attempt to address what I believe is the unstated premise underlying Mr. Ruhm's letter: that the profession's investigation and discipline process is essentially untrustworthy and that the strictest procedures possible are required to keep it from unfairly and summarily convicting actuaries.

The facts do not support his premise. The ABCD was established nearly a decade ago, and it has handled hundreds of complaints, inquiries, and requests for guidance since then. The ABCD has not run roughshod over the profession for the past 10 years, demonstrating that it is not likely to do so in the future.

All five of the U.S.-based actuarial organizations rely on the ABCD. Those five organizations have the opportunity to individually evaluate the way the ABCD handles its cases when they consider and act upon recommendations for discipline from the ABCD. This creates a system of checks and balances on the ABCD's authority, thereby safeguarding the rights of the membership. If the discipline process were fundamentally unfair, one or more of the organizations would have raised serious objections.

The ABCD is a board of nine prominent practitioners who are carefully selected by the presidents and presidents-elect of the five U.S.-based actuarial organizations. There is no reason to anticipate that, once appointed to the ABCD, those thoughtful and respected individuals would suddenly start abusing their colleagues, nor is there reason to think that the U.S.-based organizations would allow or participate in such abuse.

It is always possible to imagine the worst possible outcome. As actuaries, we are trained to identify, quantify, and address risks, but we do so most effectively when our analyses are grounded in accurate factual data. The risks underlying Mr. Ruhm's concerns simply are not supported by the facts.

## Calendar

### AUGUST
**1** President's Advisory Committee meeting, Washington
**2** Executive Committee meeting, Washington
**21** Life Risk-Based Capital Committee meeting, Washington

### SEPTEMBER
**10-11** Casualty loss reserve seminar, New Orleans
**13-14** ASPA LA benefits conference, Universal City, Calif.
**13-14** SOA valuation actuary symposium, Boston
**17-18** ASB meeting, Washington
**19** Financial Reporting Council meeting, Boston
**20** Board of Directors meeting, Boston
**22-26** NAIC fall national meeting, Boston

### OCTOBER
**3-5** CAS globalization and technology seminar, Glasgow, Scotland
**5-7** IAA meeting, Hong Kong
**8-9** Illustration actuary seminar, Orlando, Fla.
**14-17** CCA annual meeting, San Antonio
**21-24** SOA annual meeting, New Orleans
**28-31** ASPA annual conference, Washington

### NOVEMBER
**4-5** Pension Practice Council meeting, San Diego, Calif.
**8** Committee on State Life Insurance Issues meeting, Orlando
**11-14** CAS annual meeting, Atlanta
**12-15** Life and health seminar, Washington
**13** Academy annual meeting, Atlanta
**13** Casualty Practice Council meeting, Atlanta
**29-30** Retirement issues symposium, Lake Buena Vista, Fla.
**Nov. 30-Dec.1** Council of Presidents meeting, Scottsdale, Ariz.

### DECEMBER
**3** President's Advisory Committee meeting, Washington
**3-4** ASB meeting, Washington
**4** Executive Committee meeting, Washington
**8-12** NAIC winter national meeting, Chicago

### MARCH
**7-8** ASB meeting, Washington
**7-8** CAS ratemaking seminar, Tampa, Fla.
**10-13** Enrolled Actuaries meeting, Washington
**16-20** NAIC spring meeting, Reno, Nev.
**17-22** IAA meeting, Cancun, Mexico

### MAY
**19-22** CAS spring meeting, San Diego
**30-31** SOA spring meeting (financial reporting, product development), Colorado Springs, Colo.

### JUNE
**24-26** SOA spring meeting (health, pension), San Francisco

**PLANNING AHEAD?** **Bookmark the complete calendar at www.actuary.org/calend.htm.**

# Johansen Receives Local Honor

**The Adirondack Actuaries Club presented Academy President Larry Johansen with an award for exemplary service to the profession at its June 18 spring meeting in Albany.**

Barry Bablin presents award to Larry Johansen.

**The award, which is new this year, is designed to recognize members' outstanding contributions to the actuarial profession. "Larry was the ideal choice for this award given the tremendous amount of volunteer work he has done in his various roles with the Academy," said Club President Barry Bablin, who made the presentation.**

**In operation since 1982, the club is primarily composed of actuaries in upstate New York, western Massachusetts, Vermont, and Connecticut.**

# Annual Meeting Set for Nov. 13

Mark your calendars now for the Academy's 2001 annual meeting Nov. 13 at the Marriott Marquis Hotel in Atlanta. The luncheon meeting will feature the presentation of the 2001 Jarvis Farley Service Award and a speech by attorney Ralph Levy, a leading expert in professional responsibility litigation.

The meeting is being held in conjunction with the Casualty Actuarial Society's (CAS) annual meeting Nov. 11-14. All Academy members who are registered for the CAS meeting are automatically invited to attend the Academy luncheon free. For members not registered for the CAS meeting, the cost is $50. For further information, contact the Academy's Meeting Planner Denise Winston (202-223-8196 or winston@actuary.org). A brochure with registration information will be included with the September *Update*. For information about the CAS meeting, go to **www.casact.org**.