



# NAIC Defers Meeting, Not Work

IN THE WAKE OF Hurricane Katrina, the National Association of Insurance Commissioners (NAIC) canceled its fall meeting, scheduled for Sept. 10-13 in New Orleans. But action on many Academy projects continues to move forward.

In August, the Committee on Property and Liability Financial Reporting delivered a 241-page report on risk transfer in P/C reinsurance to the NAIC's Casualty Actuarial Task Force (CATF). The report contains the results of a survey of current industry practices as well as a summary of alternative approaches to evaluating risk transfer that were suggested by practicing actuaries. The report doesn't endorse any given option but gives possible advantages and disadvantages of various approaches.

Begun last April at the request of the NAIC, the report is intended to assist in an NAIC analysis of risk transfer in the context of reinsurance accounting. New York insurance superintendent Howard Mills, quoted in a Sept. 6 *Best's Insurance News* article on the Academy report,



said the report confirms that there is no universal standard to define what finite reinsurance is but also broadens the scope of risk transfer alternatives, making it clear that one size will not fit all.

Subsequent to the cancellation of the fall meeting, the NAIC's consideration of the report was re-scheduled for an interim meeting in Kansas City, Mo., on Oct. 25-26. In the meantime, the Academy is proceeding with plans to develop a practice note on risk transfer that is aimed at actuaries who are asked to assist company CEOs and CFOs in this area. The practice note should be completed by the end of the year.

CATF also received a memo in August from the Medicare Part D Subgroup, with proposed health risk-based capital (RBC) instruction and health RBC formula changes, proposed life RBC instruction and life RBC formula changes, and explanatory slides. Regulators will be reviewing the Academy's work by conference call.

Widely expected to be adopted by the NAIC's ex-  
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# Extreme Weather: Bad Luck or New Norm?

BY RADE MUSULIN

AMONG THE MANY PROBLEMS that will affect actuaries trying to price hurricane-exposed policies in coming years is evaluating whether the unusually severe seasons observed recently reflect a random streak of bad luck, a multi-decade cyclical oscillation within a stable long-term climate pattern, or a shift in climate conditions driven by global warming.

Since Hurricane Andrew exposed the limitations of using a few decades of historical data to develop property insurance prices, actuaries have increasingly turned to sophis-

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NOAA SATELLITE AND INFORMATION SERVICE

Actuarial UPDATE

## OCTOBER

- 6 Academy Social Insurance Committee meeting, Arlington, Va.
- 6-7 SOA equity-based guarantees seminar, New York
- 7 Academy Capitol Hill briefing on Social Security, Washington
- 9 Academy Board of Directors meeting, Washington
- 10-11 Academy annual meeting, Washington
- 12 Academy Casualty Practice Council meeting, Washington
- 12 Academy Health Practice Council fall planning meeting, Washington
- 12 Academy Life Valuation Subcommittee meeting, Washington
- 16-21 IAIS annual meeting, Vienna, Austria
- 19 Academy loss reserve opinion seminar, Chicago
- 21 Academy Universal Life Work Group meeting, Chicago
- 26 FASB Insurance Industry Forum, Norwalk, Conn.
- 27 Academy Risk Management and Financial Reporting Council meeting, New York
- 30-November 2 CCA annual meeting, Asheville, N.C.

## NOVEMBER

- 2 Academy Tax Work Group meeting, Las Vegas
- 3-4 Academy Universal Life Work Group meeting, Chicago
- 6 Academy Pension Practice Council meeting, Portland, Ore.
- 6-9 ASPPA annual conference, Washington
- 7 Academy Pension Committee meeting, Portland, Ore.
- 8-11 Academy Life and Health Qualifications Seminar, Washington
- 9 CIA professionalism workshop, Toronto
- 9-10 ASB Pension Committee meeting, Washington
- 10-11 CIA general meeting, Toronto
- 13-16 CAS annual meeting, Baltimore
- 13-16 SOA annual meeting, New York
- 17-19 IAA Council and committee meetings, Rio de Janeiro, Brazil
- 17-20 NCOIL fall meeting, San Diego
- 19-20 IAA President's forum, Rio de Janeiro, Brazil

## DECEMBER

- 1-2 NAIC Life and Health Actuarial Task Force meeting, Chicago
- 3-5 NAIC winter meeting, Chicago
- 4 Academy Risk Management and Financial Reporting Council Meeting, Chicago
- 6 Academy COPLFR meeting, Chicago
- 8 CIA professionalism workshop, Montreal

### WEB INTERFACE

Links to documents identified in bold blue are included in the online version of this issue at [www.actuary.org/update/index.htm](http://www.actuary.org/update/index.htm).

# Academy NEWS Briefs

## LETTER FROM THE PRESIDENT

Dear Friends and Colleagues,

This letter is written to you in the weeks following the terrible devastation that occurred in New Orleans and other Gulf Coast communities as a result of Hurricane Katrina and Hurricane Rita. By the time you read this in October, some of the immediate surge of human misery will have abated. But the effects of these calamitous storms will continue to reverberate in the affected communities, and in the hearts and minds of all Americans, for years to come.

On behalf of Academy members and staff, I wish to express our deepest sympathies to those who have suffered a loss. Recovery is going to take years, but our profession has a vital role to play both now and in the future.

As a first step, the Academy and the American Society of Pension Professionals and Actuaries have created a Hurricane Katrina **message board** as a service for actuaries and ASPPA members. Whether you need assistance in the aftermath of Katrina, or want to provide assistance, or want to share other thoughts and information with your colleagues, you're invited to use this forum.

Second, the Academy's executive committee will be considering a number of temporary changes to the Academy's membership policies to accommodate members who were affected by the hurricanes. We have also set up a system to replace any Academy materials that a member may have lost as a result of the storms (see below).

If you would like to help the victims of Hurricane Katrina and Hurricane Rita in Louisiana, Mississippi, and Alabama, I would urge you to donate to the charity of your choice, to the Actuarial Foundation's program to replenish math supplies in Gulf Coast schools (see Page 9), or to the American Red Cross (for more information on donating to the American Red Cross, visit its website at [www.redcross.org](http://www.redcross.org), or call 800-435-7669).

I am confident that each of us will do all that we can to help our neighbors on the Gulf Coast overcome this tremendous calamity.

Sincerely,

Robert E. Wilcox  
President

## Starting Over

**A**CADEMY MEMBERS who are missing materials or publications as a result of Hurricane Katrina or Hurricane Rita should contact Virginia Keene, the Academy's communications assistant (202-223-8196; [keene@actuary.org](mailto:keene@actuary.org)). She will arrange for the replacement of all materials, including membership certificates, directories, and publications of the Actuarial Standards Board. Other Academy publications, such as the *Life and Health Valuation Law Manual* and the *Property/Casualty Loss Reserve Law Manual* will also be replaced at no cost.

Members who have relocated to new or temporary office buildings and homes can change their contact information online by going to the home page of the Academy website ([www.actuary.org](http://www.actuary.org)). Click on "Update your record," and follow the instructions to change your Academy file. You can also e-mail your information to [corrections@actuary.org](mailto:corrections@actuary.org). Be sure to provide identifying information, including your name and, if possible, a contact phone number. Or write to Membership Operations, American Academy of Actuaries, 1100 17th St., N.W., 7th floor, Washington, D.C. 20036.

**CRUSAP News** **Mindy Reiser** has been hired to serve as project manager for the Critical Review of the U.S. Actuarial Profession (CRUSAP), the Academy's presidential task force that is identifying and analyzing risks and opportunities facing the actuarial profession.

Reiser, who started her duties in early September, will work with the task force and its advisory panel as they conduct their research and analysis and, moving forward over the course of the next year, as they develop strategies for the future. Reiser most recently served as a senior consultant at Synectics for Management Decisions, an Arlington, Va., firm that provides research, statistical, and information technology services to a host of clients, including the Department of Health and Human Services, the Department of Education, the Census Bureau, and the Social Security Administration. She has also worked in central Asia evaluating economic development projects supported by the Agency for International Development.

Reiser holds a doctorate in social policy from Brandeis University and master's degrees in international affairs and journalism from Columbia University.

**Fred Kilbourne** is the chairperson of CRUSAP. Other members are **Bob Collett**, **Guy King**, **Jim Rech**, and **Terri Vaughan**.

**Centennial Thoughts** The Society of Actuaries (SOA) has published a new monograph featuring papers from the second Living to 100 and Beyond: Survival at Advanced Ages Symposium that was held last January. In addition to papers from authors from around the world, including Canada, China, Germany, India, Japan, Mexico, the Philippines, Taiwan, the

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United Kingdom, and the United States, the monograph contains transcribed question-and-answer sessions from the symposium. The monograph is available online at <http://www.soa.org/ccm/content/research-publications/library-publications/monographs/life-monographs/living-to-100-and-beyond-monograph/>. A CD-ROM version is also available for purchase by contacting Jan Schuh by e-mail ([livingto100@soa.org](mailto:livingto100@soa.org)). The Academy was a participating organization in the symposium.

**It's Academic** Testimony by Academy Senior Pension Fellow **Ron Gebhardt** at a June 14 hearing of the House Ways and Means Subcommittee on Social Security is part of the syllabus for a public policy class being taught this fall at Harvard's Kennedy School of Government. In his testimony, Gebhardt laid out the argument for raising the retirement age as a solution to Social Security's long-term funding shortfall.

**International Aid** Over the course of the past year, **Caren Clark**, program manager of the Actuarial Standards Board, has lent her editorial expertise to the International Actuarial Association (IAA) in the development of IAA practice guidelines for complying with international accounting standards. The first set of practice guidelines

—also known as class 4 international actuarial standards of practice (IASP)—were recently finalized and are available as IASPs 2-8 on the IAA's [website](http://www.iaa.org). The IAA is now at work on its next set of practice guidelines.

#### ERMII Update

At a Sept. 25-26 inaugural meeting of the newly formed Enterprise Risk Management Institute International, the Academy joined other professional organizations as members of the ERMII advisory board. Academy Executive Director **Kevin Cronin** will serve as the Academy's representative on the advisory board. Academy member and former Iowa insurance commissioner **Terri Vaughan** will serve as a member of the ERMII board of directors, representing Drake University in Des Moines, Iowa, where she is a professor of insurance, risk management, and actuarial science.

**P/C Loss Reserve Manual** Orders are now being taken for the 2005 edition of the Academy's *Property/Casualty Loss Reserve Manual*. The manual, published in a variety of media to allow you to choose the version that best suits your needs, will be ready for delivery in December. See the flyer enclosed with this mailing of the *Update*, or contact Kasha Shelton, the Academy's legislative manager, by e-mail ([Shelton@actuary.org](mailto:Shelton@actuary.org)).

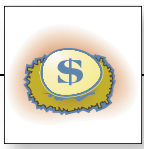
**Numbers Stud** A new television commercial for Hewlett-Packard features a geeky young comic artist touting his underground comic strip, "The Actuary." The main character, the kid explains, has all sorts of risk-related adventures. And he *always* gets the girl.

#### IN THE NEWS

A Sept. 17 *New York Times* article on the 13 percent jump in the basic Medicare premium for 2006 quoted **Richard Foster**, Medicare's chief actuary. Foster, who said that the premium paid by beneficiaries covered one-fourth of the cost of benefits under Part B of Medicare, spoke on the same topic in an item that ran Sept. 16 on Bloomberg.com.

► **James Turpin**, a former Academy vice president for pension issues and president of the Turpin Consulting Group in Albuquerque, N.M., was quoted in a Sept. 2 St. Louis *Post-Dispatch* article on pension demands in the strike by Boeing Co.'s union machinists. Turpin said that the difference between the current level and the top-line demand of the union could cost Boeing about \$1.2 billion more in the next 30 years. Turpin said he used simplistic assumptions to make the calculation: 50-year-old workers with average company service of 25 years and plans to retire at age 65. The calculation also assumed the pension increase applied to the workers' future company service.

► The *National Underwriter* ran an item in its Aug. 22 issue on the NAIC's informational hearing in Minneapolis on replacing formulaic reserving with a principle-based system that relies on the judgment of the actuary. The Academy made the lead presentation at the hearing.



## Testimony on Relative Value

**D**ONALD SEGAL, the Academy's incoming vice president for pension issues, testified at an Aug. 24 Internal Revenue Service (IRS) hearing on re-proposed regulations governing the disclosure of the relative value of optional forms of benefits under defined benefit plans. Segal's testimony was based on a comment **letter** that the Pension Committee wrote in May when the regulations were first proposed.

"We wholeheartedly support the intent of the regulations," Segal told the IRS panel. "We just feel the regulations are not good for the maintenance of defined benefit plans."

Segal singled out two primary concerns about the regulations: the potential conflict between the regulations and professional standards and the potentially overwhelming level of detail for plan participants.

### Potential conflict with professional standards

Segal told the panel that standards of practice require actuaries to ensure that their services are not used to mislead. Allowing an explanation of benefits that describes certain optional forms as equal in value to a qualified joint and survivor annuity (QJSA), assuming an actuarial present value of at least 95 percent of the QJSA present value, could create a conflict with adhering to these standards. He urged the panel to consider the Pension Committee's recommendation that regulations be modified so that only optional forms worth between 95 and 105 percent of the QJSA for a married participant could be described as approximately equal. Additionally, he suggested modifying the special grouping rule to allow the same range of values to be approximately equal in value for married and unmarried participants.

Segal also pointed out that professional standards require the use of "reasonable assumptions." The proposed regulations do not clarify whether the assumptions should be reasonable from the perspective of the individual participant or from the perspective of the plan. Segal outlined four points for modification:

- ▶ Clarify that reasonableness does not mean reasonableness from the individual participant's perspective and that standard mortality tables, even unisex tables, would be permissible.
- ▶ Further clarify that life expectancies must be based on plan or general population statistics instead of individual circumstances.
- ▶ Establish that 417(e)(3) rates will constitute a safe-harbor definition of reasonableness.
- ▶ Establish that in option comparisons, assumptions based on a plan's definition of actuarial equivalence are a safe-harbor definition of reasonableness.

### Overwhelming level of detail for participants

At the most recent Enrolled Actuaries Meeting, IRS representatives confirmed that relative values for separate segments of a participant's benefit payable at the same annuity starting date could not be disclosed separately for each segment. As a result, instead of 11 illustrations, there could be 30 line items that would need to be disclosed. Segal suggested to the panel that regulations be modified to allow sponsors to segment relative-value illustrations if there exist separately determined portions of benefits under the plan.

Segal also said that one interpretation of the final regulations would require the development of relative values of retroactive options as of a current annuity starting date and current rate. This interpretation would seem to ignore the parenthetical language, which wasn't included in the regulations as originally proposed, that clarifies that the relevant annuity starting date is intended. Segal told the panel that the IRS needs to clarify that relative values are determined separately for each illustrated start date. However, if the values are expected to be calculated at a single date, the regulations should more clearly explain what that date is and how the rule is applied.

—HEATHER JERBI

## Academy Hosts Pension Revival Meeting

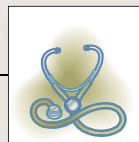
**O**N SEPT. 6, THE ACADEMY hosted a daylong meeting of a working group of Conversation on Coverage, a policy group devoted to increasing pension coverage for American workers.

The meeting brought together individuals from a broad spectrum of stakeholders in the pension system to discuss new types of plans with a defined guaranteed benefit that would

be attractive to employers that don't currently sponsor defined benefit (DB) plans or that might otherwise terminate their DB plans.

An initiative of the Pension Rights Center, Conversation on Coverage is funded by grants from the Ford Foundation and the Annie E. Casey Foundation. Sponsoring organizations are AARP, the Employee Benefit Research Institute, MetLife, Nationwide, and the Retirement Security Project. The Academy is a co-spon-

soring organization, along with the American Benefits Institute, the American Council of Life Insurers, the AFL-CIO, the ASPPA Pension Education and Research Foundation, the Capital Research and Management Co., Fidelity Investments, the International Association of Machinists and Aerospace Workers, the National Committee to Preserve Social Security and Medicare, Prudential Financial, and the U.S. Chamber of Commerce.



# Academy Pushes for Clarification on Circular 230

IN JUNE, the Internal Revenue Service (IRS) released final Circular 230 regulations governing all professionals, including actuaries, who practice before the IRS. The new regulations outline best practices for professionals who advise taxpayers on tax issues or other communication with the IRS.

Concerned about applying certain parts of the regulations to the work of pension actuaries, the Academy's Pension Committee sent a comment letter in May to the IRS. In the absence of any formal response from the IRS, the committee drafted a follow-up letter specifi-

The new regulations outline best practices for professionals who advise taxpayers on tax issues or other communication with the IRS.

cally requesting a written response or an advisory opinion on the application of certain sections of Circular 230 to actuarial practice.

The revised letter discusses several issues not touched upon in the initial letter, including:

► **Confidentiality** Circular 230 would appear to classify actuarial reports under engagement letters as covered opinions. Covered opinions typically require the confidentiality of a work product so as

to limit circumstances in which a third party could obtain access and use the information for unintended purposes.

► **Incomplete Data** Circular 230 states that any assumption that the practitioner knows (or should know) is incorrect or incomplete is an unreasonable factual assumption, and prohibits the use of an unreasonable factual assumption in both covered opinions and other written advice. Because virtually no data set that is used in pension valuation is entirely complete and accurate, Circular 230 could make it impossible for a pension plan to obtain required actuarial valuations.

► **Actuarial Reports and Schedule B** Circular 230 appears to consider both a Schedule B and its associated actuarial report as written advice with respect to a federal tax issue. Since actuarial reports are governed by professional standards under the regulations of the Joint Board for the Enrollment of Actuaries, the Academy's letter suggests that for the purpose of Circular 230 the IRS shouldn't define such reports as written advice.

The remainder of the letter reiterates the committee's earlier request for guidance on the meaning of an exception on the qualification of a qualified plan; on the treatment, in general, of tasks apparently not covered by the exception; on the status of the actuary who is not authorized to practice law; and on the applicability of Circular 230 to issues in areas where the enrolled actuary is not authorized to practice before the IRS.

—HEATHER JERBI

## Medical Reinsurance Options

AS INTEREST GROWS in the possibility of offering government-sponsored reinsurance to health plans as part of an effort to reduce soaring health care premiums, the Academy would like a word. Several words, in fact.

In a new **backgrounder**, created for legislators and other policy-makers who are evaluating the idea, the Academy walks through some of the issues that will need to be considered when designing a government reinsurance program, including

- Would participation be voluntary or mandatory?
- What issues should be considered for programs at the state, federal, and combined state and federal levels?
- Will the attachment point be increased over time and, if so, how?
- How would moral hazard be minimized?
- How should variations in costs by geographic area be addressed?
- How should the accumulation period be defined?
- What types of services would be eligible for reimbursement?

The backgrounder grew out of a July meeting on the topic that Academy Senior Health Fellow Cori Uccello and Rob Bachler, a member of the Academy's Medical Reinsurance Work Group, had with Rep. Paul Ryan (R-Wis.). At the meeting, Uccello and Bachler also gave Rep. Ryan a copy of the Academy's January **issue brief**, *Medical Reinsurance: Considerations for Designing a Government-Sponsored Reinsurance Program*, a primer on the current commercial medical reinsurance market that outlines some of the issues to be studied in designing and implementing a government program.

### PENSION PRACTICE COUNCIL IN BRIEF

The Pension Accounting Committee sent an Aug. 18 **letter** to the Financial Accounting Standards Boards with concerns that will need to be addressed if FAS 87 is reconsidered in response to a Securities and Exchange Commission staff report on off-balance-sheet entities.

► **JOHN STEELE**, a consulting actuary with Watson Wyatt Worldwide in Stamford, Conn., has joined the Pension Accounting Committee. The new vice chairperson of the committee is **STEPHEN ALPERT**, a principal with Mercer Human Resource Consulting in New York.

► **JACK MCARTHUR**, a senior consultant with Aon in Lyndhurst, N.J., has joined the Stock Options Task Force.

### HEALTH PRACTICE COUNCIL IN BRIEF

**SHAUN PETERSON**, an actuary with Allianz Life Insurance Co. in Minneapolis, is the new chairperson of the Academy's Stop-Loss Work Group.

► **DARRELL KNAPP**, a partner at Ernst & Young in Kansas City, Mo., has joined the Academy's Actuarial Equivalence PDP/MAPD Practice Note Work Group.

► **ARTHUR LEWIS**, an actuary with Presbyterian Health Plan in Albuquerque, N.M., has joined the Academy's Uninsured Work Group and its Disease Management Work Group.

► **CHAN PHAN**, an actuarial analyst with Caremark in Scottsdale, Ariz., has joined the Medicare Supplement Work Group.

# New Academy Officers

The Academy's Board of Directors has approved the slate of 2006 Academy officers put forward by the Nominating Committee. New officers will assume their duties at the Academy's annual meeting, Oct. 10-11 in Washington. The new officers are:



**Steven Lehmann**, president-elect. Lehmann is a former vice president for property/casualty issues, former chairperson of the Casualty Practice Council, and a former regular member of the Academy's Board of Directors. He is a principal and consulting actuary in the Bloomington, Ill., office of Pinnacle Actuarial Resources Inc. Lehmann is a past president of the Casualty Actuarial Society (CAS), where he is a fellow, and is a former chairman of the CAS Board of Directors. He has served on a number of CAS committees and task forces, including as chairman of the CAS Syllabus Committee, the CAS Task Force on Education, and the CAS Membership Survey Task Force. Lehmann also served as chairman of the Actuarial Standards Board's (ASB) Ratemaking Subcommittee and as a member of the ASB's Task Force on Rate of Return. He is also a fellow of the Society of Actuaries and the Canadian Institute of Actuaries and is an honorary fellow of the British Institute of Actuaries.



**David Sandberg**, vice president for life issues. Sandberg is a former regular member of the Academy's Board of Directors, a former vice chairperson of the Life Practice Council, and a former chairperson of the Life Financial Soundness/Risk Management Committee and the Life Experience Subcommittee. He is also a former member of the Risk Management and Financial Reporting Council. Sandberg is vice president and corporate actuary with Allianz Life Insurance Co. in Minneapolis. A fellow of the Society of Actuaries, Sandberg is vice chair of the International Actuarial Association's (IAA) Insurance Regulation Committee and has participated in a joint IAA/American Council of Life Insurers research project on accounting for insurance contracts. He will succeed Donna Claire.



**Donald Segal**, vice president for pension issues. Segal is the former vice chairperson of the Pension Practice Council and former chairperson of the Pension Committee. Currently a consultant with Chicago Consulting Actuaries in New York, Segal recently retired as senior vice president and actuary with The Segal Co. in New York. A fellow of the Society of Actuaries (SOA) and a member of the Conference of Consulting Actuaries (CCA), Segal has served on the SOA's Board of Governors and as chair of the SOA's Pension Section Council, as well as a member of numerous other SOA committees. He is currently a member of the CCA's Board of Directors and has served as chair of CCA's Annual Meeting Committee and of the Joint Program Committee for the SOA/CCA Spring Pension Meeting. Also an enrolled actuary, Segal is a member of the Joint Program Committee of the Enrolled Actuaries Meeting and has served two times as chair. Segal has also served as chair of the IRS Advisory Committee for Tax Exempt/Government Entities, as a member of the Joint Board for the Enrollment of Actuaries Advisory Committee on Examinations, and as a member of the Pension Practitioners Liaison Group of the IRS Northeast Key District. He will succeed Ken Kent.



**Timothy Tongson**, vice president for risk management and financial reporting issues. Tongson is the former vice chairperson of the Risk Management and Financial Reporting Council and former chairperson of the Banking and Financial Services Task Force and of the Federal Charters Work Group. He is executive vice president and chief valuation actuary for Swiss Re Life & Health Americas in Armonk, N.Y. Tongson is a member of the Society of Actuaries' Reinsurance Section Council. A member of the American Council of Life Insurers (ACLI) Actuarial Committee and of the ACLI CEO Deputies Group for Reserve Modernization, Tongson is also a past president of the Twin Cities Actuarial Club. He will succeed Burt Jay.

# Taking Stock of an Amazing Year

BY BOB WILCOX

**A**S I NEAR THE CONCLUSION of my amazing year as Academy president, it is natural to look back to where I began, to examine what I thought would be, to reflect on what might have been, and to take stock of the trails I have taken.

With the departure of Academy Executive Director Rick Lawson last December, the first major task of my term was not of my choosing: We needed to find a new leader for the Academy's great staff. The president's advisory committee moved quickly to form a search committee and hire a search firm. While no time was wasted, it took almost half a year before Kevin Cronin, the new executive director, was on board. In the process, I discovered four important things:

- The capability and dedication of our amazing staff as it moved forward without missing a beat;
- The great leadership of incoming president Peter Perkins, who traveled to the Academy office every week to steady the helm;
- The value placed on the Academy by the large number of applicants for the position;
- Most important, a perfect fit, as Cronin, an experienced leader with the skills and dedication to support the Academy and the profession for many years to come, moved into his new position.

I would like to thank everyone who made this process work.

Congress and the Bush administration promised to make 2005 a politically interesting time with discussions of Social Security, Medicare, pension funding, taxes, tort reform, and just about every other topic that could turn the spotlight on actuaries. The Academy was in the news nearly every day, trying to keep the information flow ac-

curate and fair. With 52 million media impressions in the first four months of 2005 (more than in all of 2004), it was hard to pick up a newspaper and not find some reference to actuaries. Relying heavily on the expertise of Academy Senior Pension Fellow Ron Gebhardt-sbauer and Senior Health Fellow Cori Uccello, the Academy was able to conduct briefings and respond to the constant flow of questions in a timely manner.

In March, the profession received the final report of the Morris Review, an independent study of the actuarial profession in the United Kingdom with global implications. Which of the report's concerns might apply to the U.S. actuarial profession? Which of



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## Academy Offers Free Webcast on Actuarial Communication

Communication is an essential aspect of professional practice. But effective communication of sophisticated and highly technical actuarial work can be difficult.

### THE ACADEMY WANTS TO HELP

In a free webcast at noon (EST) on Nov. 29, Academy experts will discuss the litigation, professionalism, and public interest aspects of actuarial communications. In addition to a consideration of the disclosure requirements of the code of professional conduct, the session will feature examples of how (and how not) to communicate actuarial findings.

By logging on and listening, you can earn an hour of professionalism CE credit.

**SPEAKERS:** **Lauren Bloom**, general counsel and director of professionalism; **Donna Claire**, immediate past vice president for life issues; **Ken Kent**, immediate past vice president for pension issues.

### INTERESTED?

You can register online at [www.actuary.org](http://www.actuary.org). Questions? Contact Rita Winkel, the Academy's legal assistant ([winkel@actuary.org](mailto:winkel@actuary.org); 202-223-8196).

the recommendations to overhaul the profession over there would be entirely inappropriate for the profession over here? What are our own unique risks? Questions such as these prompted the Academy to form the Critical Review of the U.S. Actuarial Profession (CRUSAP) task force. The next question—how will the profession respond to the recommendations that CRUSAP and its chairperson Fred Kilbourne will present in coming months?

Perhaps the high point of the year for me was the Academy's 2005 Spring Meeting. With 32 solid sessions on topics of general and specific interest to actuaries from all practice areas, the meeting was a resounding success. We covered the political side with Treasury Secretary John Snow, the international view with Rod Lester from the World Bank, and the Morris Review with U.K. Government Actuary Chris Daykin; and we built our understanding of accounting issues with Donald Nicolaisen, chief accountant for the Securities and Exchange Commission, and Paul Boyle, chief executive of the U.K. Financial Reporting Council. The Academy's volunteers did a great job of sharing their cutting-edge work with the profession.

As I consider the past year, I could go on and on about the accomplishments of our volunteers and staff. I wouldn't really know where to stop, so I will stop here. Yes! It has been a great year. I cannot take credit personally for very much that has happened, but I can certainly point with grateful pride to being part of a profession that includes so many who are the cream of the crop. I extend my thanks to every member of the Academy for giving me this honor and opportunity to serve for a brief moment in time as your president.

**Bob Wilcox becomes the Academy's immediate past president on Oct. 10.**

## ACADEMY SPOTLIGHT

## Risk Management and Financial Reporting Council

Financial Reporting Policy Analyst: Ethan Sonnichsen (sonnichsen@actuary.org; 202-785-7866)

Vice President: Burt Jay

**A**LL OF THE ACADEMY'S practice councils deal with risk management and financial reporting issues, but when an issue is expansive enough to affect multiple areas of actuarial practice, it becomes the responsibility of the Risk Management and Financial Reporting Council. Volunteering with the council often requires an actuary to examine issues from a different perspective than he or she is used to and to look at problems through an unfamiliar lens. It is not an easy task. Managing and responding to the council's issues demands understanding and compromise, and Academy volunteers who take this on do an extraordinary job.



providing analysis and commentary on these issues, and all of those work products are available on the Academy [website](#).

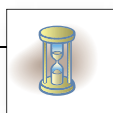
**Federal Regulation of Insurance**

The council continues to monitor progress in the development of the State Modernization and Regulatory Transparency (SMART) Act in the House Financial Services Committee. The council has also commented on an optional federal charter plan proposed by the Optional Federal Charter Coalition, an ad hoc organization whose members include the American Bankers Association, the American Council of Life Insurers, the American Insurance Association, and the Financial Services Roundtable. Enclosed with the council's comments was a copy of the council's 2003 [monograph](#) on the role of actuaries in a federal regulatory system. In March, council members met with representatives of the Government Accountability Office to discuss actuarial work, insurance supervision issues, and the impact of actuaries on product development and pricing. The council followed up on questions that arose at the meeting with further [comments](#).

**WHAT'S BEEN DONE**

Over the past six months, the council has monitored a wide variety of issues, from the rapid development of insurance regulatory principles and standards on the international level to the global convergence of accounting standards, the continuing evolution of enterprise risk management, and the possibility of federalized insurance supervision. The council has been actively involved in

## [ LIFE NEWS ]



## Regulatory Road Trip

**A**S PART OF AN EFFORT to promote a principle-based approach to reserving (see story, Page 12), the Academy is taking its show on the road.

Members of the Universal Life Work Group have been crisscrossing the country over the course of the past six months to meet with individual state insurance regulators who are members of the National Association of Insurance Commissioner's (NAIC) Life and Health Actuarial Task Force (LHATF). So far, Academy teams have met at least once and sometimes twice with 15 of the 18 members of LHATF. Further meetings are planned throughout the fall leading up

to the NAIC's winter meeting in Chicago.

The purpose of the meetings is twofold: to gather comments and feedback from each member of LHATF on the principle-based approach that the Academy is developing and to increase the regulators' understanding of the concept, said Dave Neve, the chairperson of the work group.

"We find that we get a much more focused discussion by meeting one on one than if we just present our progress at each quarterly LHATF meeting," Neve said. In fact, Neve said, many of the regulators have used the meetings as an opportunity to educate their

staff on principle-based reserving. In an early September meeting with the Connecticut Insurance Department, for instance, there were 15 people in the room, Neve said.

"Generally speaking, the meetings are helping to accelerate the process and to increase the understanding by regulators of the Academy's proposal," Neve said. While acceptance is by no means a "slam-dunk," Neve said, the meetings have been a key part of the Academy's success in moving the project along.

So far, meetings have been held with regulators in Alaska, Arkansas, California,

**VOLUNTEERS NEEDED**

**A subgroup of the Universal Life Work Group is looking for volunteers to help as it ensures that variable universal life products follow the principle-based reserve methodology currently being developed. The subgroup will be identifying specific issues related to variable universal life and will be working with other work group subgroups to come up with solutions. Interested in helping? Contact Bruce Friedland (bruce.friedland@hartfordlife.com; 860- 843-5541).**

## Financial Reporting

The council serves as the Academy's liaison to a number of financial reporting entities. Through its Financial Reporting Committee, the council has established a pattern of meeting annually with various accounting and auditing stakeholders. This year, the committee met with representatives from the American Institute of Certified Public Accountants on April 11, the Public Company Accounting Oversight Board and the Securities and Exchange Commission on June 23, and will meet with the Financial Accounting Standards Board (FASB) on Oct. 26. The council brings together representatives from all practice areas to provide valuable input to these organizations on issues of mutual interest. These meetings have fostered relationships leading to more active Academy involvement in significant accounting and auditing guidance development.

## International Issues

In the international arena, the council has been involved in a tremendous amount of activity. In March, the council **commented** on International Actuarial Association (IAA) practice guidelines for ac-

### RISK MANAGEMENT AND FINANCIAL REPORTING COUNCIL IN BRIEF

In an Aug. 5 **letter** to the Optional Federal Charter Coalition, which is drafting an optional federal charter of insurance proposal for introduction as legislation in the current congressional session, Academy President Bob Wilcox said that any federal insurance proposal should include an Office of the Chief Actuary component and define a "qualified actuary" as a member of the Academy.

► The Risk Management and Solvency Committee submitted **comments** Aug. 18 on an International Association of Insurance Supervisors' draft paper, *Supervisory Standard on Suitable Forms of Capital*.

tuaries working with new international accounting standards. The council is currently working with the Academy's Council on Professionalism and the Actuarial Standards Board to adapt those guidelines for the United States as a series of practice notes. In August, the council **commented** to the International Association of Insurance Supervisors on the development of various global standards for assessing insurer solvency and met with representatives of the NAIC to discuss its approach toward both those standards and related accounting guidance from the International Accounting Standards Board (IAIS).

## Enterprise Risk Management

Recognizing early on the importance of enterprise risk management (ERM), a rapidly evolving concept that incorporates many of the skills of actuaries in managing organizational risk, the council developed an ERM task force in January that offers all North American actuarial organizations a forum for discussing various ERM-related initiatives under consideration. The task force is currently drafting an article for *Contingencies* that provides an overview of ERM and the potential it holds for actuaries.

### WHAT'S PLANNED

- A series of practice notes adapting the IAA practice guidelines for international financial reporting standards for U.S. actuaries.
- Comment letter to the FASB on the definition of insurance risk and insurance contracts.
- Coordination with other actuarial organizations on developing an actuarial framework for enterprise risk management.
- Participation in the FASB Insurance Industry Forum on Oct. 26.
- Comment letters to the IAA and the IAIS on international principles and standards for assessing insurer solvency.

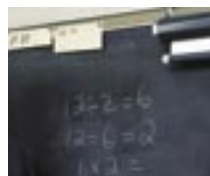
Connecticut, Florida, Kansas, Minnesota, Nebraska, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, and Texas.

### LIFE PRACTICE COUNCIL IN BRIEF

A Life Financial Reporting Committee work group is revising a January 2005 practice note on the FASB's DIG B36, which concerns modified coinsurance and FAS 133. When the revisions are complete, the updated version will be posted on the Academy's website. In the meantime, if you have questions about the practice note, contact the Academy's life policy analyst, Amanda Yanek ([yanek@actuary.org](mailto:yanek@actuary.org), 202-223-8196).

► **KENNETH VANDE VREDE**, a supervising actuary at Genworth Financial in Richmond, Va., has joined the Academy's Life Capital Adequacy Subcommittee.

► **JOHN MORRIS**, a principal consultant with PricewaterhouseCoopers in Downingtown, Pa., has joined the Academy's Life Valuation Subcommittee.



## Help Rebuild Math Classrooms Devastated by Hurricanes. Make a Contribution that Adds Up.

The Actuarial Foundation is seeking donations to help math teachers rebuild their classrooms and provide students with math tools they are unable to personally replace, such as lost calculators. (The cost of a TI-83 Plus graphing calculator is \$90 to \$100.)

### There are several ways you can help:

- Go to [www.actuarialfoundation.org/donor/donor.htm](http://www.actuarialfoundation.org/donor/donor.htm) and click on Rebuild Math Classrooms.
- Write a check payable to the Actuarial Foundation, noting that the contribution is to rebuild math classrooms, and send it to The Actuarial Foundation, Rebuild Math Classrooms, 475 N. Martingale Rd., Suite 600, Schaumburg, Ill. 60173-2226
- Donate TI-83 Plus graphing calculators or TI30XIIS scientific calculators (must be clean and in good working order) by mailing them to the address above.

For more information go to

[www.actuarialfoundation.org/donor/mathclassrooms.htm](http://www.actuarialfoundation.org/donor/mathclassrooms.htm).

# Academy Meets with Indian Regulators

**R**EPRESENTATIVES FROM the Insurance Regulatory and Development Authority (IRDA) of India paid a visit to the Academy on Sept. 21, as part of a trip that also included stops at the Washington Department of Insurance Securities and Banking and the National Association of Insurance Commissioner's Washington office. The IRDA delegation was led by C.R. Muralidharan and included a member of his staff and a host from the McLean, Va., office of the consulting firm BearingPoint.

Also attending the meeting were Susan Pino, a principal with Deloitte Consulting in McLean, Va., Kevin Cronin, the Academy's executive director, Craig Hanna, the Academy's director of public policy, and Ethan Sonnichsen, the Academy's policy analyst for risk management and financial reporting issues.

Muralidharan led off the discussion with an overview of the growing insurance market in India and the role of the IRDA. Historically, the market consisted of the state-run Life Insurance Corp. of India and General Insurance Corp. of India. In 2000 and 2001, the market was opened to privatization and foreign investment. As a testament to the attractiveness of the market and a growing economy, there are now more than 20 insurance companies operating in India, though Muralidharan said that the

health market is only just beginning to develop. The IRDA faces numerous challenges in establishing a regulatory structure at the federal level that keeps pace with a growing and evolving market. Likewise, the actuarial profession in India is relatively small and must expand to meet the needs of both companies and the IRDA.

Cronin offered an overview of the U.S. actuarial profession and highlighted the

role and structure of the Academy and its sister organizations. Pino answered questions regarding the reserving process (from a purely casualty perspective) and addressed the exam and accreditation process for actuaries. Other topics of discussion were the development of actuarial standards and professionalism issues and the relationship between the Academy and various regulators, legislators, and standards-setting bodies.



Susan Pino, left, discusses U.S. actuarial accreditation with a delegation from the Insurance Regulatory and Development Authority of India.

## Rewarding Research

**F**IVE PROJECTS RECENTLY received grant funding from the Actuarial Foundation's Actuarial Education and Research Fund (AERF) Committee and from the Society of Actuaries' Committee on Knowledge Extension Research (CKER) as part of the 2005 Individual Grants Competition.

Vytaras Brazauskas, University of Wisconsin, received a joint grant from CKER and the Casualty Actuarial Society to develop an ensemble of improved data-analysis procedures offering various trade-offs between robustness and efficiency. The impact of such procedures on credibility premium calculations will be investigated and quantified.

Sebastian Jaimungal, University of Toronto, received a grant from CKER to investigate the pricing and hedging of equity-linked insurance products, such as equity-indexed pure endowments and equity-indexed annuities, under a stochastic interest rate environment in which the risky asset is exposed to stochastic volatility and jumps and mortality are modeled via a stochastic hazard rate process.

Bruce Jones, University of Western Ontario, received a grant from

CKER to develop and explore a risk model that considers the impact of pricing cycles on insurers' ruin probabilities. He will use the model to study strategies for coping with cyclic business environments.

Kristen Moore, University of Michigan, received a grant from CKER to examine optimal surrender strategies and product design for equity-indexed annuities. Using stochastic optimal control, she will study policyholder behavior and then examine contract features such as participation rates, death, benefits, minimum guarantees, and fees that yield a product that is desirable for the investor and profitable for the insurer.

Anthony Webb, Boston College, and researcher Irena Dushi received a grant from CKER and AERF to study the aggregate mortality risk faced by annuity insurers, as well as the risk of lower-than-expected average mortality in the population from which the insurer draws its annuity pool.

For information on the 2006 Individual Grants Competition, go to [www.actuarialfoundation.org/research\\_edu/prize\\_award.htm#individual](http://www.actuarialfoundation.org/research_edu/prize_award.htm#individual). ▲

ticated catastrophe simulation models. To date, the predominant view of modeling experts has been that models should reproduce the observed frequency and severity of hurricanes over the past century or so. In fact, the Florida Commission on Hurricane Loss Projection Methodology, which was created by state statute to review models, codified this view. But if a model's estimate is designed to randomly reproduce the average hurricane frequency and severity observed over the past century, then it will not show cyclical variation or a shift to more activity over time due to global warming.

Consider a deck of cards. Select a card at random, then replace it in the deck and select a card again. The probability of getting a black face card on several successive draws is low, but possible, and constant over many repetitions. In this case, unusual results are the result of randomness in the card selection process.

Most experts agree that hurricane activity in the Atlantic basin follows a cyclical pattern over several decades. For example, activity in the 1940s through the mid-1960s was above average, while from the mid-1960s through the 1980s it was below average. Models could be, but generally are not, adjusted to reflect a cyclical pattern. If they were, the long-term average would not change, but the forecast over shorter time horizons would.



What's wrong with this picture? Perhaps Fido doesn't quite understand his assignment. Be sure you do when you take one on.

Consider another card analogy, where three decks of cards were combined by taking all of the spades and clubs from a second deck and adding them to the first, then taking all of the hearts and diamonds from a second deck and adding them to a third. If cards are randomly selected from each of the two remaining decks, the probability of a black face card will be higher in one and lower in the other but the same in total as in the single-deck example. In this case, a cycle could be simulated by selecting a card from the first deck 20 times in a row, then selecting a card from the second deck 20 times in a row, and so forth.



Scientists are not in agreement on whether the recent activity in the tropics is a consequence of global warming. Several prominent experts have discounted a link between recent extreme seasons and global warming, while others have produced studies showing an increase in severe storms is unrelated to the multi-decade cycle.

Consider a final twist on the card analogy, where a single deck is used but a black face card is added on each draw. The probability of getting a black face card would increase over time, so the long-term average would no longer be the correct estimate for either a short or a long period. This is an example of parameter shift over time.

Actuaries facing hurricane exposure should consider the potential impact of cycle and parameter shifts on their estimates. This is particularly important if the frequency of severe hurricanes is changing, because damage functions are non-linear. Actuarial Standard of Practice (ASOP) No. 39, *Treatment of Catastrophe Losses in Property/Casualty Insurance Ratemaking*, states that ratemaking procedures using models should "...appropriately reflect the expected frequency and severity distribution of catastrophes." It is not sufficient simply to show that a model reproduces the past; the model should simulate the conditions that are expected to exist in the future.

Unfortunately, it is unlikely the scientific community will reach a consensus on whether global warming is affecting hurricane activity anytime soon, forcing actuaries to rely on conflicting expert opinions in unfamiliar areas. When doing so, actuaries should refer to ASOP No. 38, *Using Models Outside The Actuary's Area of Expertise (Property and Casualty)*, carefully document their assumptions, and make users aware of factors contributing to significant uncertainty.

**Rade Musulin is chairperson of the Academy's Communications Review Committee, a member of the Update's editorial board, and vice president - operations, public affairs, and reinsurance for the Florida Farm Bureau Insurance Cos. in Gainesville, Fla.**

#### CASUALTY PRACTICE COUNCIL IN BRIEF

► In a Sept. 8 letter, the Workers' Compensation Subcommittee warned the Senate Judiciary Committee that an asbestos bill pending in the Senate could invite double filing of claims and cost the workers' comp system billions of dollars.



# Academy Pushes Principle-Based Approach

BY ANDREW ERMAN



**F**OR DECADES, REGULATORS have relied upon formula-based approaches to solve regulatory challenges. Life insurance industry actuaries have used formulas prescribed by regulators to derive minimum standards for capital levels, reserves, and cash values (more technically, nonforfeiture values). Historically, this has fit with the industry's offerings since products were relatively homogenous and conducive to this approach.

Today, consumers demand more complicated and exotic products, distribution channels are becoming savvier, and life insurance products consequently drive more dynamic and unpredictable solvency challenges, particularly considering the economic risks to a whole organization. Consider the development of universal life products with shadow accounts, equity-indexed products (both life and annuities), and variable annuities with complicated living benefits and death benefits. Consider companies that offer a different combination of products, sometimes in conjunction with a hedging program, sometimes alongside similar product features reinsured back from Europe or Asia. Clearly, it is becoming more difficult to apply the same formulaic regulatory approaches to this evolving complexity of product offerings.

Years ago, the Academy's Life Practice Council began tracking this evolution in our strategy sessions. We came to the consensus that the best way to move forward was to begin breaking from the formulaic "band-aid" approaches of the past. Rather than continuing to force the newer, square pegs into the same old round holes, we felt that a new approach would be necessary.

In the property/casualty world, actuaries set loss reserves relying on a combination of generally accepted practices and professional judgment. Certain health insurance reserve methodologies (specifically, IBNR—incurred but not reported) need to satisfy specified constraints, but those constraints allow the

actuary a reasonable degree of professional discretion. In pensions, actuaries exercise judgment within the bounds of strong professional standards. Why was the life world still stuck in formulaic approaches?

With the push for C-3 Phase 2 (a new approach to assessing capital adequacy using economic scenarios and actuarial professional judgment), the Life Practice Council concluded it would be more appropriate for the regulators to set guiding principles rather than formulas. This was the dawn of the principle-based approach and it is now being applied in C-3 Phase 2, effective as early as year-end 2005.

Now we are digging deeper to articulate those principles better than ever before. For our universal life principle-based reserving initiative, we have identified many specific principles to guide the actuary in exercising his or her professional judgment. The Universal Life Work Group prepared a **paper** that describes the conceptual framework for a principle-based approach as well as seven recommended principles.

Although a bit more slowly, another group is also working to come up with new ways to develop products that do not have to rely on the minimum prescribed formulas for cash values. Again, we believe that a better approach exists where cash values can be developed relying on the professionalism of the actuary, who, in turn, relies on principles set forth by the regulators. More details are available in a **progress report** prepared in June by the Academy's Nonforfeiture Improvement Work Group for the National Association of Insurance Commissioners' Life and Health Actuarial Task Force.

If we design these principle-based approaches properly, we can expect this new infrastructure to meet the challenges that lie ahead more robustly than the formulaic approaches of the past.

**Andrew Erman is a member of the Update editorial review board and has been a member of the Life Practice Council since 2001.**

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## NAIC, *Continued from Page 1*

executive and plenary committees at the fall meeting, the Academy's C-3 Phase 2 risk-based capital (RBC) **project** was also put on hold because of the meeting cancellation. However, the Academy is still looking for year-end implementation and has begun work on C-3 Phase 3, RBC requirements for life products under a principle-based reserving approach (for a discussion of the principle-based approach, see story above).

Prior to the canceled meeting, the Academy's Universal Life Working Group delivered an updated version

of its draft **framework** for principle-based life reserve valuation to the NAIC's Life and Health Actuarial Task Force (LHATF). The revised principles reflect input from regulators, the industry, and interested parties.

Also in advance of the meeting, the Academy's State LTC Experience Forms Work Group provided LHATF with a final draft of long-term care experience **forms, instructions, and examples**. These final drafts, reflecting input from the regulators, will be reviewed by conference call. ▲