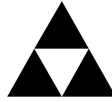

AMERICAN ACADEMY *of* ACTUARIES

ACADEMY ALERT

GENERAL INSURANCE ISSUES
2009-G-16
December 23, 2009

2009 ACADEMY LEGISLATIVE/REGULATORY REVIEW

The annual Academy legislative/regulatory review focuses on significant legislative and regulatory activities affecting the actuarial community, as well as the Academy's accomplishments during the past year. Much of the Academy's work in 2009 focused on systemic risk and financial regulatory reform, health care reform, and the principle-based approach to life reserves and capital. As discussed in the Risk Management and Financial Reporting section, the Academy also held its first-ever Financial Summit in July where Academy leaders and stakeholders gathered to discuss how the Academy should respond to the recent financial crisis.

Health

House and Senate Health Reform Overhaul Bills

On Nov. 7, the U.S. House of Representatives passed a bill intended to help fulfill President Obama's goals for reducing health care costs, protecting and increasing consumers' choices, and guaranteeing access to quality, affordable health care for all Americans. The Affordable Health Care for America Act (H.R. 3962) would:

- Cover about 96 percent of legal residents under the age of 65, according to the Congressional Budget Office (CBO);
- Impose a mandate requiring individuals to purchase health coverage and impose a 2.5 percent tax penalty on their income if they fail to acquire coverage;
- Impose a mandate for employers with payrolls above $250,000 annually—employers choosing to not comply would face a tax penalty of 8 percent of their payroll;
- Eliminate or reduce the penalty for small employers with annual payrolls less than $750,000;
- Beginning in 2013, provide subsidies for individuals and families with annual income up to 400 percent of the poverty level (or $88,200 for a family of four);
- Cap out-of-pocket costs;
- Establish a Health Insurance Exchange, beginning in 2013, to help create a marketplace where individuals and employers could purchase health insurance from public or private insurers, including new health insurance co-ops;
- Create a public insurance option financed by its own premiums that would be administered by the Secretary of Health and Human Services and would allow the Secretary to negotiate rates for providers opting to participate in the public health insurance option;
- Prohibit insurers from engaging in discriminatory practices such as refusing to sell or renew policies due to a person's health status and excluding coverage of treatments for pre-existing health conditions; premiums could vary only by age (no more than 2:1), geography, and family size;
- Establish a voluntary, public, long-term care insurance program to help people purchase services when they have functional limitations. The program would supplement traditional payers of long-term care (e.g., Medicaid and/or private long-term care insurance). This provision is known as the Community Living Assistance Services and Supports Act, otherwise known as the CLASS Act. The Academy and the Society of Actuaries completed an analysis of the actuarial issues and policy implications of a federal long-term care insurance program for members of the Senate Health, Education, Labor and Pensions (HELP) Committee on July 22. http://www.actuary.org/pdf/health/class_july09.pdf).

On Nov. 6, the Academy's Health Practice Council sent a comment letter to Speaker Nancy Pelosi (D-Calif.) and House Republican Leader John Boehner (R-Ohio) providing an actuarial perspective on HR 3962 and outlining how the bill conforms with three key considerations for a sustainable health insurance system. According to the letter, for insurance markets to be viable they must attract a broad cross section of risks; market competition requires a level playing field; and for long-term sustainability, health spending growth must be reduced. The letter can be found at https://www.actuary.org/pdf/health/ahcaa_nov09.pdf.

The Senate version of the bill, the Patient Protection and Affordable Care Act, is under debate on the Senate floor. Much like the letter sent to the House leadership, a Nov. 20 letter from the Health Practice Council was also sent to Senate Majority Leader Harry Reid (D-Nev.) and Senate Minority Leader Mitch McConnell (R-Ky.) addressing the key considerations for health care reform for the Senate version of the bill.

The Patient Protection and Affordable Care Act would:

- According to the CBO, ensure that 94 percent of legal residents have health insurance coverage.
- Impose a mandate for individuals to obtain insurance, with a phased-in penalty for noncompliance ($95 in 2014, $350 in 2015, and $750 in 2016);
- Set the age variance for premiums at 3:1 and tobacco use at 1.5:1;
- Require employers with more than 200 employees to automatically enroll employees in plans;
- Impose an assessment ($750 per full-time employee) on employers with more than 50 full-time employees (FTE) that do not offer coverage and have at least one FTE that receives a tax credit through the exchange;
- Provide tax credits for small employers and individuals and families making up to 400 percent of the federal poverty level ($88,000 for a family of four);
- Create state-based exchanges through which individuals and small businesses with up to 100 employees can purchase qualified coverage. Requires the Office of Personnel management to contract with insurers to offer at least two multi-state plans in each exchange.
- Establish nonprofit, member-owned health insurance cooperatives to compete with private insurers;
- Allow employees to keep the coverage they have (i.e., grandfather in existing plans).

The Academy's Nov. 20 letter regarding the Patient Protection and Affordable Care Act can be found at http://actuary.org/pdf/health/ppaca_nov09.pdf.

Key Academy considerations for health reform can also be found in the April 22 testimony from Cori Uccello, the Academy's senior health fellow, at a hearing of the House Ways and Means Committee. The testimony is available at http://www.actuary.org/pdf/health/reform_testimony_may09.pdf. An additional statement for the record was submitted for a follow-up hearing on June 24 (http://www.actuary.org/pdf/health/health_systems_june09.pdf), and a May 22 comment letter from the Academy's Health Practice Council was sent to the Senate Finance Committee in response to its May 14 policy options paper, *Expanding Healthcare Coverage: Proposals to Provide Affordable Coverage to All Americans*.

In addition to these letters, statements, and testimony, the Academy's Health Practice Council sent a Nov. 23 comment letter to Sen. Tom Harkin (D-Iowa), chairman of the Senate HELP Committee, and Sen. Max Baucus (D-Mont.), chairman of the Senate Finance Committee, after receiving committee requests for information related to the effect of grandfather provisions within the recently introduced Patient Protection and Affordable Care Act. In the letter, the Health Practice Council concluded that provisions in the Senate bill would help mitigate rate shock (significant premium increases) for those who stay with their existing coverage. The letter can be found at http://www.actuary.org/pdf/health/ppaca_grandfather_nov09.pdf.

Throughout 2009, the Academy's Health Practice Council paid a significant amount of attention to health care reform and worked hard to bring a crucial and unique perspective to the health care reform dialogue. To aid policymakers in their health care reform education and their work, the Health Practice Council created a section on the Academy's website dedicated to this purpose. In a series of policy statements, *Critical Issues in Health Reform*, policymakers and the public can find links to each of these informative statements, as well as other thought-provoking pieces on the wide-ranging subject of health care reform. The Critical Issues in Health Reform section of the Academy's website can be found at https://www.actuary.org/issues/health_reform.asp.

Hill Briefings/Webcasts

The Academy has also held a number of Capitol Hill briefings and webcasts for congressional staff and the media this year. The first briefing of the year focused on risk pooling. During the briefing, actuaries explained risk pooling basics and discussed implications of rating rules and pooling mechanisms for small-group and individual health insurance markets. Panelists included Cori Uccello, the Academy's senior health fellow, and David Shea, Jr., chair of the Academy's Federal Health Committee. Slides from the briefing can be found at http://www.actuary.org/pdf/health/pools_mar09.pdf. An archived video of the briefing can be found at http://www.actuary.org/briefings/health_mar09.wmv. The Academy's March issue brief, *Risk Classification in the Voluntary Individual Health Insurance Market*, can be found at http://www.actuary.org/pdf/health/risk_mar09.pdf.

On May 20, the Academy sponsored a Hill briefing via webcast on actuarial perspectives on health risk adjustment and how it can be used to accomplish several goals in the context of health reform. Topics of discussion included a clear definition of risk adjustment from the actuarial perspective; how it is currently used in public programs and private plans; how risk adjustment can help reduce effects of adverse selection; and how risk adjustment can align incentives, prevent gaming and protect insurers accepting risk. Speakers at the briefing included Ross Winkelman, Michelle Raleigh, and Mita Lodh. Handouts from the webcast can be found at http://www.actuary.org/webcasts/docs/health_may09.pdf. An archived webcast can be found at https://actuary.webex.com/actuary/onstage/g.php?AT=VR&RecordingID=562547432.

On June 22, the Academy hosted an in-person briefing designed to help answer questions on the various provisions that influence the actuarial viability of health care reform proposals. Topics included how the provisions affect adverse selection and why mitigating adverse selection is a critical component of ensuring actuarially viable reform; what you need to know to ensure a level playing field with private plans when considering a public insurance plan option; and what you need to know about actuarial equivalence and how it is used to compare different benefit packages. Panelists included Catherine Murphy-Brown, chair of the Academy's Uninsured Work Group, David Shea, Jr., chair of the Academy's Federal Health Committee, and Karl Madrecki, a member of the Academy's Health Practice Council. Slides from the briefing can be found on the Academy's website (http://www.actuary.org/briefings/pdf/health_june09.pdf).

On Nov. 2, a joint work group of the Academy's Health Practice Council and the Society of Actuaries held a webcast for media and congressional staff in conjunction with the release of a detailed technical report on the necessary start-up capital requirements for health insurance cooperatives and a public plan option. Under the modeled scenarios, the work group found that start-up capital requirements ranged from $1.7 billion to $45.6 billion. The wide variation is attributable to three unknowns—how many people enroll, the difference between pricing assumptions and actual claims, and average claims.

Medicare Reform

On May 12, the Medicare Board of Trustees released its 2009 report on the financial status of the Medicare program. According to the report, Medicare's Hospital Insurance (HI) trust fund assets are projected to be depleted by 2017, at which time tax revenues are projected to cover only 81 percent of HI program costs. This share will decrease rapidly thereafter. Beginning in 2008, HI expenditures exceeded all HI income including interest. There is no current provision in the program that would allow for general fund transfers to cover HI expenditures exceeding payroll tax revenues.

The value in today's dollars of the HI deficit over the next 75 years is $14 trillion. Eliminating this deficit would require an immediate 134 percent increase in payroll taxes or an immediate 53 percent benefits reduction, or a combination of the two.

The Supplementary Medical Insurance (SMI) trust fund is projected to remain solvent, because its financing is reset every year to meet future costs. Therefore, future increases in SMI expenditures will require premium increases and larger general revenue contributions to maintain solvency.

For the fourth year in a row, the difference between Medicare outlays and dedicated financing sources is projected to exceed 45 percent within the next seven years. As a result, this report again triggers a Medicare excess general

revenue funding warning. The funding warning requires the president to submit legislation addressing this shortfall to Congress within 15 days after submitting the fiscal year 2011 budget next year. However, in January 2009, the House passed a rules package that eliminates the requirement for House legislative activity regarding the Medicare trigger for the duration of the 111th Congress.

Shortly after the report was released, the Academy's Medicare Steering Committee released its annual issue brief, *Medicare's Financial Condition: Beyond Actuarial Balance*. With the release of this updated issue brief on Medicare's financial condition, the Academy also issued a *Call to Action*, urging policymakers to undertake comprehensive Medicare reform. The statement outlined four goals that any comprehensive reform of the program must seek to achieve: the HI trust fund must meet the short-range test of financial adequacy, the trust's fund must also meet the long-range test of actuarial balance, the program's growing demand on the federal budget must be brought under control by a reduction in the growth in general revenue contributions, and overall Medicare spending must be brought under control by a reduction in the growth of spending. The full *Call to Action* can be found online at http://www.actuary.org/pdf/medicare/med_reform_may09.pdf. The text of the trustees report can be found at http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2009.pdf

The U.S. House of Representatives also passed a bill that would repeal a 21 percent Medicare physician fee reduction scheduled to go into effect Jan. 1, 2010. If the Medicare Physician Payment Reform Act of 2009 (H.R. 3961) also passes in the Senate, the bill would block a 40 percent cut over the next six years. Another version of the bill (S. 1776) was defeated in the Senate in October and it has been reported that H.R. 3961 will also likely not pass in the Senate.

Revised Health Opinion Instructions

The Health Practice Financial Reporting Committee released a practice note in September on the revised actuarial statement of opinion instructions for the National Association of Insurance Commissioners (NAIC) Health Annual Statement. The practice note was developed to inform actuaries of the new requirements adopted by the NAIC. The changes to the opinion instructions are effective for the 2009 annual statement filing. The revised health actuarial opinion instructions

- Require a qualified health actuary to be appointed by the board of directors;
- Prescribe language for each section; the actuary must indicate any deviations or additions to that language in a "check box" section; and
- Require a supporting Actuarial Memorandum.

The practice note is available on the Academy's website at http://www.actuary.org/pdf/practnotes/sao_sept09.pdf.

Life

Adoption of Standard Valuation Model Law (SVL)

On Sept. 23, the National Association of Insurance Commissioners (NAIC) adopted the revised Standard Valuation Model Law (SVL) which allows the implementation of principle-based reserving for life and health insurance. The action by the NAIC's Executive Committee/Plenary at the organization's Fall 2009 National Meeting required adoption of the Valuation Manual, which is being developed as a guide to the implementation of principle-based reserves, by the end of 2009; that deadline was extended at the Winter 2009 National Meeting to August 2010.

Academy committees and work groups have been providing support to the NAIC on the revised SVL for at least five years, and have submitted a number of proposals, recommendations, and amendments to many committees, task forces, and working groups within the NAIC regarding the SVL and the Valuation Manual.

It is expected that the revised model law and the initial Valuation Manual will be circulated to the states for adoption as one package.

SEC Proposed Rule 151A: Indexed Annuities and Certain Other Insurance Contracts

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In early December, the Securities and Exchange Commission (SEC) agreed to a two-year delay in the implementation of Rule 151A, which would have required that equity-indexed annuities be regulated as securities effective Jan. 12, 2011. Previously, on July 21, the U.S Court of Appeals for the D.C. Circuit ordered the SEC to reconsider its adoption of Rule 151A [74 F.R. 3138 (Jan. 16, 2009)]. The court, in *Equity Investment Life Insurance Company, et al v. SEC* [(D.C. Cir. 2009), No. 09-1021], held that the SEC's interpretation of "annuity contract" is reasonable in Rule 151A, but remanded the rule for reconsideration because it found that the SEC failed to properly consider and analyze the effect of the rule upon efficiency, competition, and capital formation as required.

Prior to the final publication of Rule 151A in January, the Academy submitted comments to the SEC on the characteristics and treatment of equity-indexed annuities from the perspectives of both the consumer and the insurer in September 2008 (http://www.actuary.org/pdf/life/sec_sept08.pdf) and in November 2008 (http://www.actuary.org/pdf/life/sec_nov08.pdf). A copy of the court's opinion can be found at http://pacer.cadc.uscourts.gov/common/opinions/200907/09-1021-1197327.pdf.

Previously, on June 4, Rep. Gregory Meeks (D-N.Y.) introduced the Fixed Indexed Annuities and Insurance Products Classification Act of 2009 (H.R. 2733), which would nullify the SEC's authority to regulate indexed annuities under Rule 151A. Sen. Ben Nelson (D-Neb.) introduced a companion bill (S. 1389) to H.R. 2733 on June 25. Neither bill has seen any committee action after being referred to the Senate Banking Committee and House Financial Services Committee, respectively.

C3 Phase II - Principle-Based Approach to Capital for Variable Annuities

In July, the Variable Annuity Practice Note Work Group released a practice note on the application of C-3 Phase II and Actuarial Guideline 43 (CARVM for variable annuities). The practice note contains new information on compliance with Actuarial Guideline 43, which is effective Dec. 31, 2009. It is also an update of a 2006 practice note on applying C-3 Phase II, which has been part of the NAIC's RBC instructions since 2005. The new practice note is available on the Academy's website at http://www.actuary.org/pdf/life/c3p2_july09.pdf.

The Academy and the Society of Actuaries jointly-sponsored a seminar in May and a webcast in June on implementation of Actuarial Guideline 43, with a strong focus on the Academy practice note on this topic. The presentation slides for both of these events are available at www.soa.org.

Risk Management and Financial Reporting

The Financial Crisis and Regulatory Reform

On July 20, the Academy held its first-ever Financial Summit in Washington, where over 60 Academy leaders and stakeholders examined the actuarial landscape in view of globalization, the 2008-2009 financial crisis, and the Academy's plans for shaping future regulatory responses. The scope of discussion ranged from solvency and risk management for insurance and financial institutions, to the more universal risk management challenges facing the financial security system. A full report from the summit can be found at http://www.actuary.org/events/2009/summit/pdf/report.pdf.

Shortly after President Obama's State of the Union address in January, Treasury Secretary Timothy Geithner released the administration's *Financial Stability Plan*, which presented a general framework for the repair of the financial system. On June 17, the Treasury Department released its own financial regulatory reform proposal which called for the creation of a Financial Services Oversight Council and proposed giving the Federal Reserve the authority to supervise all financial firms posing threats to financial stability. The Treasury Department's plan, *A New Foundation: Rebuilding Financial Supervision and Regulation*, can be found at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

Another part of Treasury's plan was sent to Congress on June 30 to create an Office of National Insurance within the Treasury and a new Consumer Financial Protection Agency (CFPA) to take responsibility of existing consumer protection functions of the Federal Reserve System, the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA).

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On Dec. 11, the U.S. House of Representatives passed its version of the overall administration financial regulatory reform plan, H.R.4173, the Wall Street Reform and Consumer Protection Act of 2009.

The bill would regulate the financial services industry through many directives, including:

- Requiring an audit and congressional report of the Federal Reserve Board's actions during the recent economic crisis;
- Establishing a Financial Services Oversight Council, chaired by the secretary of the Treasury with representation from federal financial regulatory bodies, that would regulate financial companies;
- Creating a process by which the Federal Deposit Insurance Corporation would be given authority to resolve, liquidate, or take action on a financial company whose default would endanger U.S. financial stability;
- Granting the Commodity Futures Trading Commission (CFTC) exclusive authority over non-security-based swaps and giving the Securities and Exchange Commission (SEC) exclusive authority over security-based swaps, with the two agencies consulting with each other over any new swap regulations;
- Forming the CFPA to regulate the condition of consumer financial products or services;
- Creating a financial reporting forum for discussion of short-term and long-term issues significant to financial reporting;
- Establishing a Federal Insurance Office (FIO) housed under the Treasury Department, which would monitor the insurance industry, identify gaps in insurance regulation that could contribute to systemic risk in the insurance industry or the U.S. financial system, and assist in conducting the terrorism insurance program;
- Requiring the FIO director to study and provide congressional reports on the global reinsurance market and measures to modernize insurance regulation in the United States.

On Nov. 10, Sen. Chris Dodd (D-Conn.) unveiled a draft bill that would consolidate regulatory authority over the banking industry into one new agency, the Financial Institutions Regulatory Administration. The Restoring American Financial Stability Act would also establish the Office of National Insurance (ONI), the Consumer Financial Protection Agency (CFPA), and the Financial Stability Agency, a council of regulators that would monitor and regulate financial institutions posing significant threats to systemic risk. Specifically, the bill would authorize the director of the ONI to conduct a study on ways to improve insurance regulation regarding systemic risk regulation, capital standards, and the international coordination of insurance regulation. The director would also be required to perform a value assessment of possible federal insurance regulation of various lines of insurance (excluding health insurance). The bill is expected to be debated in the coming year.

Systemic Risk

On March 5, the U.S. House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Enterprises held a hearing to assist the Financial Services Committee in crafting legislation to create a systemic risk regulator for the financial services industry. James Rech, the Academy's vice president for Risk Management and Financial Reporting, submitted written testimony explaining how actuarial solvency and risk concepts would be useful in approaching how to structure the role of the systemic risk regulator. The testimony can be found at http://actuary.org/pdf/finreport/risk_testimony030509.pdf.

In April, the Academy released a white paper on successful concepts for addressing systemic risk. The white paper can be found at http://actuary.org/pdf/finreport/risk_april09.pdf.

On Sept.29, the Academy and the Society of Actuaries (SOA) hosted a Capitol Hill briefing on regulating financial risk. The briefing focused on risk management principles applied in the insurance arena, the actuarial profession's work concerning systemic risk, and development of public policy options evolving from actuarial work. With Henry Siegel moderating the panel, Academy speakers included Jesse Schwartz, chair of the Financial Regulatory Reform Task Force, and Robert Miccolis, vice chair of the same task force. Shaun Wang presented for the SOA. Slides from the briefing can be found at https://www.actuary.org/briefings/pdf/systemic_risk_sept09.pdf.

Derivatives Reform

On Jan. 24, the National Conference of State Legislators' (NCOIL) Steering and Financial Services & Investment Products Committees heard testimony from experts regarding the advantages and disadvantages of regulating the

credit default swap market on the state level. A major part of the debate was whether credit default swaps should be classified as securities or insurance. To add an actuarial perspective to the debate, the Academy's Risk Management and Solvency Committee submitted testimony, *Actuarial Principles, Risk Management Principles, and Insurance Principles for the Solvency & Risk Management of Credit Default Swaps (CDS) - Why and How?* The testimony can be found at http://actuary.org/pdf/finreport/ncoil_jan09.pdf. On Nov. 22, NCOIL's Executive Committee voted to adopt its proposed Credit Default Insurance Model Legislation. The Risk Management and Solvency Committee had provided comments to NCOIL's Financial Services & Investment Products Committee regarding the legislation on July 9 at the NCOIL Summer Meeting in Philadelphia. The comments can be found at http://actuary.org/pdf/finreport/ncoil_july09.pdf.

Derivatives Trading Accountability and Disclosure Act

On July 22, Rep. Michael McMahon (D-N.Y.) introduced a bill to further regulate the derivatives market. H.R. 3300, the Derivatives Trading Accountability and Disclosure Act of 2009, would require any person participating in the process of buying or selling derivatives to register with the Treasury Department and comply with its disclosure and reporting requirements. The bill would also create the Office of Derivative Supervision within Treasury to coordinate with the SEC and the CFTC, and to develop comprehensive and standardized regulations governing the buying and selling of derivatives. The bill was referred to the House Financial Services and Agriculture Committees, but there was no further congressional action.

On Dec. 2, the Senate Agriculture Committee held a hearing on over-the-counter derivatives reform and addressing systemic risk. Henry Siegel, vice president of the Academy's Risk Management and Financial Reporting Council, submitted testimony for the record addressing actuarial solvency and risk concepts that could be useful in approaching how to structure the role of the systemic risk regulator and discussing systemic risk. The testimony can be found at http://actuary.org/pdf/finreport/systemic_risk_nov09.pdf.

Insurance Regulation

On March 19, Rep. Peter DeFazio (D-Ore.) and Rep. Gene Taylor (D-Miss.) introduced a bill in the U.S. House of Representatives that would repeal the McCarran-Ferguson Act's (15 U.S.C. 1011) federal antitrust exemption that applies to the insurance industry and would give the Federal Trade Commission and the Department of Justice authority to apply antitrust laws to anticompetitive behavior of insurers. The Insurance Industry Competition Act of 2009 (H.R. 1583) would not affect the ability of states to continue regulating the business of insurance. The bill was referred to the House Judiciary, Energy and Commerce, and Financial Services Committees, but saw no further action.

In addition, a repeal of the McCarran-Ferguson Act's federal antitrust exemption for the health and medical professional liability insurance sectors was added to the Affordable Health Care for America Act (H.R. 3962) before the health care reform bill passed on the House floor on Nov. 7. Additional details about the Health Insurance Industry Antitrust Enforcement Act's provisions and the Academy's work regarding those provisions can be found in the Medical Liability Reform segment of the Casualty section.

On April 2, Representatives Melissa Bean (D-Ill.) and Ed Royce (R-Calif.) introduced a bill that would give insurers, insurance agencies, and insurance producers (agencies and brokers) the option to be regulated under federal or state regulation and elect federal or state charters and licenses. Under the National Insurance Consumer Protection Act (H.R. 1880), nationally chartered and licensed entities would be primarily subject to federal laws. The bill would:

- Establish an Office of National Insurance within the Treasury Department that would give a national insurance commissioner the authority to issue charters to national insurers for life insurance, property and casualty, and reinsurance;
- Create a systemic risk regulator as defined by the administration. National and state insurance commissioners would be required to share information with the systemic risk regulator, who would then make corrective recommendations to the national or state commissioner to avoid or lessen the actions taken by an insurer or affiliate if such actions were expected to have catastrophic effects on economic conditions and financial stability. The systemic risk regulator and national commissioner could then determine if an insurer should be nationally chartered.

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Some of the provisions of the bill were seen in other financial regulatory overhaul legislation, but the bill saw no further action.

On May 21, Rep. Paul Kanjorski (D-Pa.) introduced the Insurance Information Act of 2009, H.R. 2609, which would create the Office of Insurance Information (OII) within the Treasury Department. The OII would advise the president, congress, and the secretary of the Treasury on domestic and international policy issues relating to all lines of insurance except health insurance. Rep. Kanjorski, chairman of the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, introduced the bill after conducting a subcommittee hearing on May 14 in which the subcommittee heard from insurance and risk management industry representatives on how the federal government should oversee insurance. On behalf of the Academy's Risk Management and Financial Reporting Council, James Rech submitted written testimony for the record on the current roles of actuaries in state-based insurance regulation and how they should be allowed to continue to help regulate insurance on the state level. The testimony can be found at http://actuary.org/pdf/finreport/oversight_may09.pdf. The bill's title was later changed to the Federal Insurance Office Act and was approved by the House Financial Services Committee on Dec. 2; the bill's provisions were later added to the Wall Street Reform and Consumer Protection Act of 2009.

On Nov. 24, shortly before the House passed its financial reform package, the Academy's Financial Regulatory Reform Task Force sent comments to the House Financial Services Committee on the creation of an Office of the Actuary to help guide the Federal Insurance Office with the monitoring and quantification of systemic risks, including risks unique to the insurance industry. The letter can be found at https://www.actuary.org/pdf/finreport/hr2609_nov09.pdf. A letter was also sent to the Senate Banking Committee on Dec. 22 addressing the same concerns in the Senate financial reform package to be debated in 2010. The letter can be found at http://actuary.org/pdf/finreport/hr4173_dec09.pdf.

Nonadmitted and Reinsurance Reform Act

On Sept. 9, the U.S. House of Representatives passed a bill that would streamline the regulation of surplus lines and reinsurance by vesting the domiciliary state with the sole authority to regulate and collect taxes on surplus lines and reinsurance transactions. The Nonadmitted and Reinsurance Reform Act of 2009 (H.R. 2571) would establish national standards for state regulation of surplus lines and prohibit regulators from applying their states' laws to reinsurance agreements of ceding insurers domiciled in other states. The Senate companion bill, S. 1363, was referred to the Senate Banking Committee. The bill text of H.R. 2571 is also included within Sen. Dodd's financial reform plan (a summary of the draft proposal can be found at http://banking.senate.gov/public/_files/FinancialReformDiscussionDraftRevised111009.pdf). The bill was not included in the Wall Street Reform and Consumer Protection Act of 2009. It is unclear whether the House bill will be included in the Senate's financial reform package next year.

Promoting Transparency in Financial Reporting Act

Also on Sept. 9, the U.S. House of Representatives passed a bill that would require the chairpersons or their designees of the SEC, the Financial Accounting Standards Board (FASB), and the Public Company Accounting Oversight Board (PCAOB) to present oral testimony annually for five years, beginning in 2009, to the House Financial Services Committee on their efforts to promote transparency and reduce the complexity in financial reporting. The Promoting Transparency in Financial Reporting Act of 2009 (H.R. 2664) is intended to reduce the complexity in financial reporting by providing more accurate and clear financial information to investors. The full House passed H.R. 2664 by voice vote. The bill was referred to the Senate Banking Committee on Sept. 10, but has seen no further congressional action.

International Accounting Standards

On July 1, the *FASB Accounting Standards Codification* was launched as the single source of authoritative nongovernmental U.S. Generally Accepted Accounting Principles (GAAP). This new codification presents accounting rules in a format that is very different than what actuaries are used to seeing. The way accounting issues are researched and described—and how members discuss those issues with internal and external clients and auditors—will change. For example, FAS 87 will no longer be authoritative in its current form. Instead, its content will be

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reallocated to one or more sections of the single codification document. All guidance from FASB will be known as accounting standards updates.

While the codification does not change GAAP, it introduces a new structure intended to:

- Reduce the amount of time and effort required to solve an accounting research issue;
- Improve usability of the literature, thereby mitigating the risk of noncompliance with standards;
- Provide real-time updates as new standards are released;
- Assist the Financial Accounting Standards Board (FASB) with the research and convergence efforts required during the standard-setting process.

Casualty

Medical Liability Reform

On Oct. 21, the U.S. House Judiciary Committee approved a bill that would partially repeal the McCarran-Ferguson Act's exemption for health and medical professional liability insurers that shields them from federal antitrust law. The Health Insurance Industry Antitrust Enforcement Act of 2009 (H.R. 3596) would have authorized the federal government to prosecute insurers for violations of antitrust law if they were found to be engaged in price-fixing, bid-rigging, or market allocations. The committee also adopted an amendment by Rep. Dan Lungren (R-Calif.) clarifying that the bill generally would not have applied to the collection or dissemination of historical loss data, determination of a loss development factor applicable to historical loss data, or performance of actuarial services. The text of H.R. 3596 was added to the Affordable Health Care for America Act (H.R. 3962), which passed the House on Nov. 7.

James D. Hurley, a member of the Academy's Medical Professional Liability Subcommittee, testified on H.R. 3596 before the House Judiciary Subcommittee on the Courts and Competition Policy on Oct. 8. In his testimony, Hurley stated that rather than lowering medical professional liability insurance premiums as the bill intends, the proposed legislation may result in higher premiums. Hurley added that without proper loss data, aggregation, and analyses, smaller medical professional liability insurers might not be able to compete in some markets because they might be unable to accurately determine loss costs and would therefore be exposed to excessive risk.

On Nov. 5, the Academy's Medical Professional Liability Subcommittee sent a letter to Speaker Nancy Pelosi regarding the addition of the antitrust bill's provisions to H.R. 3962. The letter concluded that this specific medical professional liability insurance reform would likely result in reduced availability with fewer willing insurers, less vigorous competition among those that do write coverage, and higher costs to the consumer.

On Sept. 17, Sen. Patrick Leahy (D-Vt.), chair of the Senate Judiciary Committee, introduced S. 1681, the companion bill to this legislation. However, at press time it is unclear whether this bill or the Senate's health care reform bill (the Patient Protection and Affordable Care Act) will be the vehicle for the antitrust exemption repeal in the Senate.

The Academy's testimony can be found at http://actuary.org/pdf/casualty/hurley_testimony.pdf. The Academy's Nov. 5 letter can be found at http://actuary.org/pdf/casualty/ahcaa_nov09.pdf. The bill text of H.R. 3596 can be found in Section 262 of H.R. 3962 at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3962eh.txt.pdf or in the original text of the Health Insurance Industry Antitrust Enforcement Act at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3596ih.txt.pdf.

Natural Catastrophe Policy

On December 21, President Obama signed a defense appropriations bill (H.R. 3326) that extends the National Flood Insurance Program (NFIP) until Feb.28, 2010.

Earlier this year, the U.S. House of Representatives passed a July 29 NFIP extension (H.R. 3139) that would extend the program through March 31, 2010. The Senate Banking Committee has not yet acted on H.R. 3139. Also this year, Rep. Gene Taylor (D-Miss.) reintroduced a related bill that would give consumers the option of purchasing one NFIP policy that would include both wind and flood insurance coverage. H.R. 1264, the Multiple Peril Insurance Act of

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2009, would not require that the specific cause of the loss, whether windstorm or flooding, be identified for the payment of a claim.

On July 9, the Academy's Extreme Events Committee's Natural Catastrophe Subcommittee submitted comments to the National Conference of Insurance Legislators' (NCOIL) Subcommittee on Natural Disaster Insurance Legislation on its proposed system for public-private natural catastrophe financing. In its comments, the Academy subcommittee noted that the proposed system's target level for the state pool should account for the potential catastrophic risks threatening the state, not simply the historical risks. The subcommittee suggested that the state pool should not target a level equivalent to 70 percent of the total insured amount that the state needs in order to cover the average exposure of the three largest natural catastrophes within the state over the last 15 years. Rather, the subcommittee recommended that the state pool target an estimated annual aggregate loss at a certain predetermined probability level. The July 9 comment letter can be found at https://www.actuary.org/pdf/casualty/cat_july09.pdf.

On Nov. 19, Academy member Marty Simons revisited the issue again with the same NCOIL subcommittee. The NCOIL subcommittee plans to continue its work in this area at its next meeting in March 2010.

Credit Scoring and Ratings

On Feb. 28, on behalf of the Academy's Casualty Practice Council, Steven Lehmann testified at NCOIL's special property-casualty insurance meeting regarding insurers' use of education and occupation data for rating and underwriting purposes. In his testimony, Lehmann pointed out that insurance laws, actuarial principles, and actuarial standards of practice generally require that insurers using occupation, education, or any other rating factor be able to demonstrate that such factors are related to expected outcomes and to demonstrate differences in losses or expenses for such classifications. In addition, rates within a risk classification are generally deemed not to be unfairly discriminatory if differences in rates reflect material differences in expected costs for risk characteristics. The testimony can be found at http://www.actuary.org/pdf/casualty/testimony_feb09.pdf.

During its summer meeting July 9-12 in Philadelphia, NCOIL amended its model credit scoring legislation to require that insurers provide a rating exemption to people affected by extraordinary events such as job loss or serious illness. The amendment requires carriers to provide a rating exemption to policyholders of personal lines of insurance experiencing financial setbacks due to specific events, most of which are related to the current financial crisis. On behalf of the Casualty Practice Council, Jeff Kucera testified before NCOIL about the actuarial effects of the amendment. He noted that, while the overall intent of NCOIL's proposed amendment to the current model act is to aid certain policyholders, passage of this amendment will have unintended consequences for other policyholders. This testimony can be found at http://www.actuary.org/pdf/casualty/personal_july09.pdf.

Earlier, Kucera testified before the NAIC in an April 30 public hearing on credit-based insurance scores. In his testimony, Kucera mentioned that the use of credit-based insurance scores helps insurance companies charge those risks that are likely to generate greater costs higher premiums, while those risks likely to generate lower costs get lower premiums. Any prohibition on the use of insurance scores will not lower overall insurance premiums; rather, it will redistribute the premium charges so that those risks with lower expected costs will pay more than is actuarially fair, while those with greater expected costs will pay less than is actuarially fair. Furthermore, total premiums collected must be sufficient to pay for total losses and expenses incurred. Thus, if any individuals or groups of insureds with higher expected loss costs have their rates suppressed, then the rest of the population, which may well have lower expected loss costs, will necessarily have their rates increased to offset this difference. The testimony can be found at http://www.actuary.org/pdf/casualty/scores_testimony_apr09.pdf. May 15 follow-up comments on the issue can be found at http://www.actuary.org/pdf/casualty/scores_comment_may09.pdf.

Pension

Social Security and Reform

On May 12, the Board of Trustees of the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds released its 2009 report on the financial status of the Social Security program. The board reports to Congress annually on the current and future conditions of Social Security, with a detailed assessment focusing on the program's next 75 years. According to the 2009 report, benefits and administrative expenses are first expected to exceed tax income by 2016, one year sooner than the projection in last year's report. By 2027, expenditures will exceed tax income plus interest

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on the trust fund assets. As a result, in order to pay full benefits and administrative expenses, the program will need to begin drawing down trust fund assets. By 2037, Social Security trust funds are expected to become exhausted, and the current Social Security law would no longer mandate the Treasury Department to cover annual deficits. At that point, annual trust fund tax revenues would cover only 76 percent of benefits. Last year's report projected that funds would be exhausted by 2041.

In 2008, the annual cost of Social Security benefits reflected 4.4 percent of gross domestic product (GDP). This is expected to be 6.1 percent in 2030 and 5.8 percent by 2083. Social Security's 75-year actuarial deficit is projected to be 2 percent of taxable payroll, which is up from last year's projection of 1.70 percent. According to the report, this change is primarily the result of the recession, slightly lower estimates for real GDP after the economy recovers in 2015, and faster reductions in mortality rates. By 2083, the shortfall of tax income would be 3.4 percent of taxable payroll, smaller than the 4.2 percent projected in the 2008 report.

The trustees' report outlines a number of ways the Social Security program could be brought into actuarial balance, including an immediate increase in payroll tax revenues of 16 percent or an across-the-board benefit reduction by 13 percent. However, the trustees note in the report that the sustainable solvency of the program would require more significant changes.

Shortly after the trustees report was released, the Academy's Social Insurance Committee released its issue brief on the report's projections, *An Actuarial Perspective on the 2009 Social Security Trustees' Report* (https://www.actuary.org/pdf/socialsecurity/trustees_09.pdf). The text of the trustees report can be found at http://www.socialsecurity.gov/OACT/TR/2009/tr09.pdf.

The Academy's Social Insurance Committee also released a September 2009 issue brief, *Understanding the Assumptions Used to Evaluate Social Security's Financial Condition*. In the issue brief, the committee made the following recommendations:

- All analyses of Social Security reform proposals that include financial projections should also include an explanation of the assumptions used;
- Any such analysis of proposals should use assumptions that are internally consistent;
- Where substantial uncertainty exists as to the appropriate level of a critical assumption, sensitivity analysis or a range of assumptions should be provided;
- When calculations for competing reform proposals use different sets of assumptions, comparisons of these proposals should recognize the effects of the differing assumptions.

Financial Crisis and Retirement

On June 22, the Academy held a Capitol Hill briefing offering the unique perspectives of the actuarial profession to guide policymakers in seeking ways to help plan sponsors and retirees adjust to the new environment resulting from the financial crisis. Speakers included Ethan Kra, vice president of the Academy's Pension Practice Council; Anna Rappaport, chair of the Society of Actuaries (SOA) Committee on Post-Retirement Needs and Risks; Andrew Peterson, staff fellow of retirement systems at the SOA; and Frank Todisco, the Academy's senior pension fellow. Slides from the Hill briefing can be found at http://actuary.org/briefings/pdf/pension_june09.pdf.

Retirement Security Needs Lifetime Pay Act

On June 8, Rep. Earl Pomeroy (D-N.D.) introduced a bill that would encourage retirees to create annuities as part of their retirement savings plans. The Retirement Security Needs Lifetime Pay Act (H.R. 2748) would: (1) Allow for an exclusion from gross income for 50 percent of lifetime income payments from certain annuity contracts of up to $10,000; (2) Exclude longevity insurance benefits from employee benefit plan minimum distribution requirements; and (3) Allow a tax exclusion for amounts received as an annuity under any portion of an annuity, endowment, or life insurance contract. H.R. 2748 has been referred to the House Ways and Means Committee.

Sen. Kent Conrad (D-N.D.) introduced the Senate companion legislation, the Retirement Security for Life Act (S. 1297), on June 18. The bill would allow for an exclusion from gross income for 50 percent of the amount otherwise includible in gross income as guaranteed payments from annuity or life insurance contracts. It would also set limits on

the amount of such exclusion to $20,000 in any taxable year and provide for an inflation adjustment of the $20,000 limitation beginning in 2011. The bill has been referred to the Senate Finance Committee.

On Nov. 18, the Academy's Pension Committee sent comments to Rep. Pomeroy regarding the provisions in H.R. 2748 and to express support for the longevity provisions in the bill. The comment letter can be found at http://actuary.org/pdf/pension/hr2748_nov09.pdf.

Preserve Benefits and Jobs Act

On Oct. 27, Rep. Pomeroy introduced a bill that would provide funding relief to defined benefit pension plans. The Preserve Benefits and Jobs Act of 2009 (H.R. 3936) would provide funding relief to both single-employer and multiemployer defined benefit pension plans. The bill has been referred to the House Ways and Means Committee and the Subcommittee on Health, Education, Labor and Pensions of the House Education and Labor Committee.

Pension Protection Act Annual Funding Notice

On Feb. 10, the Department of Labor (DOL) issued Field Assistance Bulletin No. 2009-01 announcing an annual funding notice requirement. The Pension Protection Act of 2006 (PPA) [P.L. 109-280] amended Section 101(f) of the Employee Retirement Income Security Act of 1974 (ERISA) to require all defined benefit plans that are subject to Title IV of ERISA to provide an annual funding notice to each plan participant and beneficiary, as well as to certain other parties. The PPA amendments apply to plan years beginning in 2008, with funding notices due 120 days after the end of the plan year (with exceptions for certain small plans).

The annual funding notice is required to include a general description of the plan benefits that are insured by the Pension Benefit Guaranty Corporation (PBGC). It must also include, for single employer plans, a summary of the rules governing plan termination, and for multiemployer plans, a summary of the rules governing reorganization or insolvency, including the limitations on benefit payments.

The DOL has not yet issued regulations or other guidance concerning compliance with the annual funding notice requirements. The bulletin can be found at http://www.dol.gov/ebsa/pdf/fab2009-1.pdf.

Joint Board Issues Proposed Regulations for Pension Actuaries

On Sept. 18, the Joint Board for the Enrollment of Actuaries issued proposed regulations updating and amending several requirements for pension actuaries and actuarial services governed by ERISA [74 F.R. 48030 (Sept. 21, 2009)]. The Internal Revenue Service (IRS) and the DOL share oversight of the Joint Board. Important changes in the proposed rules include those relating to: enrollment and re-enrollment, continuing professional education requirements, continuing professional education requirement waivers, enrollment status, and standards of conduct. On Nov. 20, the Academy's Pension Committee submitted comments on the proposed regulations, which are available at http://www.actuary.org/pdf/pension/erisa_nov09.pdf.

IRS Issues Final Regulations for Asset Value Method Changes in Defined Benefit Plans

On Oct. 7, the IRS released final regulations covering many parts of the minimum funding requirements and funding-based benefit restrictions imposed on single-employer defined benefit plans by the Pension Protection Act of 2006 (P.L. 109-280). These final regulations generally apply for plan years beginning on or after Jan. 1, 2010.

The final regulations include several clarifications and new rules on plan asset and liability valuation, and on the maintenance and use of funding balances. The regulations allow for automatic IRS approval of certain changes in a plan's funding method and loosen rules on applying excess contributions to a plan's prefunding balance. The final regulations [74 F.R. 53004-53084 (October 15, 2009)] can be found at http://www.regulations.gov/search/Regs/contentStreamer?objectId=0900006480a421b5&disposition=attachment&contentType=pdf.

International Accounting Standards

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As mentioned in the Financial Reporting and Risk Management section, the *FASB Accounting Standards Codification* was launched on July 1 as the single source of authoritative nongovernmental U.S. Generally Accepted Accounting Principles (GAAP). All guidance from FASB will be known as Accounting Standards Updates.

Copies of legislation mentioned in this alert can be found through the Library of Congress online legislative service (http://thomas.loc.gov). Academy publications can be found on the Academy's website http://www.actuary.org. Academy publications, as well as copies of 2009 legislation, can also be obtained by contacting Justin Edwards, the Academy's legislative assistant, by e-mail (edwards@actuary.org) or by telephone, (202-223-8196).

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