APR 2011

Actuarial UPDATE
THE NEWSMONTHLY OF THE AMERICAN ACADEMY OF ACTUARIES

CLASS Act Due for a Rewrite

WITHOUT MODIFICATIONS, the Community Living Assistance Services and Supports (CLASS) Act is likely to be unsustainable, Academy member Allen Schmitz testified at a March 17 Capitol Hill hearing.

"The actuarially sound requirement will be very difficult to achieve under the current program design," Schmitz, a member of the Academy's CLASS Act Task Force, told members of the U.S. House Committee on Energy and Commerce Subcommittee on Health. "A primary concern is the considerable potential for adverse selection in this program."

The CLASS Act is a national, voluntary long-term care insurance program included in the Patient Protection and Affordable Care Act of 2010. The program is required to be actuarially sound over a 75-year period with no support from taxpayers.

In his testimony, Schmitz identified several provisions in the act that would result in adverse selection, including:

- Guaranteed issue with a weak actively-at-work requirement;
- Opt-out and opt-in clauses that allow participants to delay coverage until it is needed;
- Subsidies requiring a premium of only $5 per month for students and those below the poverty line;
- A waiting period that is not long enough to control adverse selection effectively;
- Rate increase limitations for those who are older than age 65, have paid premiums for 20 years, and are no longer working; and
- Benefit design features, such as cash benefits and unlimited lifetime maximums, that have been and continue to be problematic in the private long-term care insurance market because they are susceptible to induced demand and may drive higher premiums and lower program participation.

Subcommittee member Rep. Joe Pitts (R-Pa.) (right) welcomes Allen Schmitz before his testimony.

Higher participation would make it easier to spread the risk, Schmitz explained, but simply increasing the participation level will not ensure the viability and success of the program. "It is the mix of individuals with different risk characteristics enrolled in the program at any one time, and not participation alone, that is the key to

SEE **CLASS ACT**, PAGE 4

Capitol Hill Briefing on Pension Risk and Retirement

Expanding Lifetime Income Options

PUBLIC POLICY GOVERNING RETIREMENT PLANS can be improved and expanded to enhance individuals' retirement security, encourage greater savings, ensure against longevity risk, and promote the pooling of risk. That was the Academy's message at an April 4 Capitol Hill briefing for congressional staffers and federal regulators.

In the 90-minute briefing, "Pension Risk and Your Retirement: Understanding Retirement Risk and Overcoming Challenges Through Public Policy Options," Ethan Kra, vice president of the Academy's Pension Practice Council, and Lane West, a member of the Pension Committee, combined a primer on retirement plans and managing retirement risks with an in-depth look at reforms that could strengthen Americans' retirement options.

"We should be encouraging people to save for retirement and promote risk pooling so we get the most efficient use of those [retirement] money," Kra said.

Noting that half the population outlives its life expectancy but that most retirees plan for their assets to last only through their life expectancy, Kra and West detailed a lengthy list of risks to a safe and comfortable retirement, including investment risk, longevity risk, inflation risk,

SEE **LIFETIME INCOME**, PAGE 5

2 **Due Date** Deadline looms for paying Academy dues and acknowledging its conflict-of-interest policy.

6 **2011 EA Meeting** Pension professionals gather in Washington to discuss national retirement.

8 **Actuarial Communications** Professionalism webinar on ASOP No.41 draws a large audience.

9 **NAIC Spring Meeting** Regulators tackle solvency modernization deep in the heart of Texas.

CALENDAR

APRIL

4 Capitol Hill Briefing: Pension Risk and Your Retirement, Washington (Academy)

6–10 IAA meeting, Sydney, Australia

14 Post-NAIC Update/PBA Webinar

27 Council on Professionalism meeting, Washington

28 Academy Executive Committee meeting, Washington

MAY

4 CUSP meeting, Atlanta

5–6 NAAC meeting, Atlanta

10 Insurance Contracts Projects Update Webinar (Academy)

18 Preparing for Change under PBA: Life Company Reserves and Capital Seminar, New Orleans (Academy, SOA)

25 Academy Board of Directors meeting, Washington

JUNE

13-15 Spring health meeting, Boston (SOA)

29 Professionalism webinar: The Profession's Responsibility to the Public (Academy, ASPPA, CAS, CCA, SOA)

JULY

14–17 NCOIL summer meeting, Newport, R.I.

AUGUST

11 Academy Executive Committee meeting, Washington

11–13 46th Actuarial Research Conference, Storrs, Conn. (SOA)

29–Sept. 1 NAIC summer meeting, Philadelphia

SEPTEMBER

15 CUSP Meeting, Chihuahua, Mexico

16–17 NAAC Meeting, Chihuahua, Mexico

21 Professionalism webinar: Code of Professional Conduct (Academy, ASPPA, CAS, CCA, SOA)

29–Oct. 2 IAA meeting, Zagreb, Croatia

OCTOBER

16–19 SOA annual meeting, Chicago

To continue receiving the *Update* and other Academy publications on time, remember to make sure the Academy has your correct contact information. Academy members can update their member profile at the member log-in page on the Academy website.

Academy NEWS Briefs

May 1 Deadlines

Academy Dues

IF YOU HAVEN'T YET RENEWED YOUR ACADEMY MEMBERSHIP, May 1 is the deadline to pay your 2011 dues to avoid a late fee. You can use our fast, efficient online dues system 24/7. Just go to www.actuary.org/dues.asp and log in. If you have any questions about your membership status or about paying dues, contact Kasha Shelton, Academy manager of membership operations (membership@actuary.org; 202-223-8196).

COI Acknowledgment

ALL ACADEMY VOLUNTEERS must respond no later than May 1 to the Academy's request to confirm their acknowledgment of the Academy's existing conflict-of-interest policy. Volunteers who do not will be dropped from their committees. The final of three Academy requests was emailed to volunteers on March 31. You can respond to the email notice from the Council on Professionalism or log in to the Academy's members-only page to access the conflict-of-interest acknowledgment link.

BOXSCORE PUBLISHED

The April 2011 edition of the Actuarial Standards Board's Boxscore is now available. This issue examines a new Actuarial Standard of Practice (ASOP) exposure draft, *The Use of Health Status Based Risk Adjustment Methodologies*, and the final revision of ASOP No. 10, *Methods and Assumptions for Use in Life*. It also provides information about a discussion draft on risk evaluation and risk treatment that has been issued for comment. The draft was developed by the ASB's Enterprise Risk Management Task Force. In addition, the *Boxscore* reviews the recent repeal of ASOP No. 2, *Recommendations for Actuarial Communications Related to Statements of Financial Accounting Standards Nos. 87 and 88*, and ASOP No. 9, *Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations*. For more background on these news items and to learn about other standards of practice currently under review, visit the ASB website.

IN THE NEWS

The Academy Public Plan Practices Task Force's report "Risk Management and Public Retirement Systems" was cited in an Op-Ed published on Feb. 1 in the *Baltimore Sun*. As described in the commentary, the report says that "states need to identify conflicts of interest within the system, clearly establish rules to ensure adequate funding, and educate administration officials and unions about the economic consequences of policy."

Academy Health Practice Council Vice President **Tom Wildsmith** discussed lifetime limits in a *New York Times* article that appeared online on Feb. 1 and in print on Feb. 2. Wildsmith said that the cost of eliminating lifetime limits on health coverage, as prescribed by the health care reform law, is fairly modest. The widely republished article also appeared in the Feb. 4 *Houston Chronicle* and the Feb. 6 *Dallas Morning News*.

Academy Multiemployer Plans Subcommittee Chairperson **Eli Greenblum**, a consulting actuary and senior vice president with the Segal Co. in Washington, discussed pension funding relief for multiemployer plan sponsors in a Feb. 3 Bureau of National Affairs article. Greenblum said that sponsors of calendar-year multiemployer plans must decide soon whether to accept funding relief that Congress gave to employers through a law enacted in June 2010.

The Academy Medical Loss Ratio (MLR) Regulation Work Group's Nov. 5, 2010, letter to the U.S. Department of Health and Human Services was

➜ CONTINUED ON **PAGE 3**

➜ CONTINUED FROM **PAGE 2**

cited in a Feb. 4 *Inside Health Policy* article. The work group wrote that a 50 percent confidence interval for MLR credibility adjustments significantly could affect issuers of smaller blocks of business and, therefore, the insurance markets in the small-population states. The work group urged regulators to increase the confidence interval to a higher level.

Academy volunteer **Steve Schoonveld** provided average costs for various long-term care services in a Feb. 8 *Time* column. He said the average cost of a nursing home stay ranges from $85,000 to $120,000 a year, while hiring an aide to spend six hours a day in the home averages around $40,000 a year.

Schoonveld also provided commentary on the Community Living Assistance Services and Supports (CLASS) Act for a *National Journal* feature that appeared online on Feb. 17 and in print on Feb. 19 and for a Feb. 24 Reuters column. Schoonveld helped to explain the Academy's adverse selection concerns with the CLASS program. He said that as currently designed, the CLASS program may not be affordable enough to attract sufficient enrollment of low-risk individuals. Without that participation, premiums could escalate and force out other participants, eventually threatening the sustainability of the program.

The Academy's concerns regarding affordability and the sustainability of the CLASS program also were highlighted in a *New York Times* article that appeared online on Feb. 21 and in the Feb. 22 print edition.

To find out about other actuaries in the news and for external links, visit the Academy's newsroom.

SPEAKERS BUREAU

Academy President **Mary Frances Miller** addressed the members of the Kansas City Actuaries Club during the club's Feb. 16 meeting. Miller's presentation, "Ensuring the Profession Has a Voice in Public Policy," looked at how the Academy provides its objective expertise to policymakers and offered examples from the Academy's work during the health care reform debate and during the law's implementation.

DISCIPLINARY NOTICE

(Effective March 28, 2011)

The Disciplinary Committee of the American Academy of Actuaries (Academy), acting in accordance with the Academy's bylaws and on a recommendation from the Actuarial Board for Counseling and Discipline (ABCD), hereby reprimands Nicolas E. De Fiori for materially failing to comply with Precepts 1 and 10 of the Code of Professional Conduct. Mr. De Fiori failed to file a required annual report for a client's employee benefit plan. After discovering the problem, he failed to notify the client or its successor actuary and address the issue until several months later. Mr. De Fiori's failure to file the annual report and the delay in taking appropriate steps to rectify the error reflect a lack of competence, do not fulfill the profession's responsibility to the public, and as such are a violation of Precept 1 of the Code of Professional Conduct.

In addition, Mr. De Fiori was unresponsive to repeated requests by a successor actuary hired by the client for documents relating to the annual report and other relevant information, and did not provide all such documentation until several months after it was first requested. Such conduct is a violation of Precept 10, which required him to perform actuarial services with courtesy and professional respect, and to cooperate with others in the principal's interest.

Based on the foregoing violations of the Code of Conduct, Mr. De Fiori is hereby reprimanded.

NOMINATIONS SOUGHT FOR 2011 MYERS SERVICE AWARD

The Robert J. Myers Public Service Award, named for the former chief actuary of the Social Security Administration, recognizes actuaries with a single noteworthy public service achievement or those who have devoted careers to public service. Nominees should be members of the Academy who have:

- Demonstrated their commitment to professionalism;
- Made an extraordinary contribution to the public good through service to the government or other organizations in the public sphere, even when facing conflicts from political pressure;
- Been an inspiration to practicing actuaries; and
- Commanded respect within and outside the profession.

For more information or to nominate a candidate, go to http://www.actuary.org/awards/myers.asp

Nominations are due by July 8.

Preparing for Change Under PBA:

Life Company Reserves and Capital Seminar

May 18, 2011, New Orleans

The seminar will feature an in-depth discussion of several hot topics and specific implementation challenges related to the principle-based approach (PBA) for statutory reserves and capital. Topics will include:

- Preliminary results/conclusions from the NAIC VM-20 Impact Study;
- Potential refinements to AG 43 and C3 Phase II based on the Oliver Wyman study;
- The structure and process of the NAIC's feedback loop;
- Implementation of C3 Phase III for life products.

The seminar is jointly sponsored by the Academy and the Society of Actuaries. Click here to register or to learn more.

long-term sustainability," he said. "High participation from only higher-risk individuals will threaten the program."

Schmitz recommended modifications to the CLASS Act that would address many of the adverse selection issues raised by the Academy:

- Add an actively-at-work definition with a minimum requirement of 20 to 30 hours of scheduled work or a comparable requirement;
- Restrict the ability to opt out and subsequently opt back in with the use of either a long second waiting period for benefits or an alternative underwriting mechanism(s);
- Include a benefit elimination period or duration limits;
- Pay benefits on a reimbursement basis rather than a cash basis;
- Include scheduled premium increases for active enrollees at either a consumer price index or alternative rate in the initial premium structure.

These modifications, along with a strong marketing program that encouraged individuals to plan for their future long-term care needs, would improve the sustainability of this voluntary long-term care program, Schmitz said.

Speaking at the same hearing, Kathy Greenlee, assistant secretary for aging at the U.S. Department of Health and Human Services (HHS), said that both President Obama and HHS Secretary Kathleen Sebelius have acknowledged that the CLASS program needs improvement, but that "we are absolutely committed to the solvency of the program, and the key to solvency is broad participation."

Greenlee said that HHS is exploring ways to strengthen the program, such as partnering with employers to disseminate outreach information and enroll employees, changing the employment and earnings requirements, and closing loopholes that could allow consumers to skip premium payments and then re-enroll without paying any penalty.

Also testifying were Joseph Antos, a scholar at the American Enterprise Institute, Mark Warshawsky, director of retirement research at Towers Watson, disability rights advocate Anthony Young, and William Lawrence Minnix Jr., chief executive officer at LeadingAge.

In a statement at the hearing, Rep. Michael Burgess (R-Texas), who chairs the Congressional Health Care Caucus, said, "The basic structure of the program is so fundamentally flawed I don't think the secretary has the authority to make the necessary changes without coming back [to Congress]."

"I don't hear any alternatives coming from the other side," countered Rep. Frank Pallone (D-N.J.), the ranking Democrat on the panel. "We're facing an impending crisis in long-term care."

CLASS Notes

In an interview with the *Update*, Allen Schmitz, a member of the Academy's CLASS Act Task Force, answered questions about long-term care (LTC) insurance and the CLASS Act.

Isn't the private long-term care market having problems with rate increases and overall profitability? Why would you suggest changes that would make this program more like private long-term care insurance?

The private LTC insurance market has had challenges that have hurt its potential growth. There was mispricing of some of the key assumptions, such as lapse rates and interest. Many of these have been corrected, and while companies have these older blocks on the books, newer policies are priced more appropriately. But it is the older blocks of business that have caused many of the problems.

Some of the changes we are suggesting are a result of what the LTC insurance industry has learned over the years. We have learned that risk classification principles and adverse selection are critical in pricing a program. We have learned that product features like cash benefits and lifetime benefits can induce demand, are very expensive, and are difficult to manage. The lessons learned from lapse assumptions and interest assumptions are well documented and understood such that those mistakes can be prevented from reoccurring.

But very few are covered by the private market—won't the CLASS Act suffer the same fate?

There are many reasons why more people don't plan for their LTC needs, whether by insurance or other means. And yes, the CLASS Act will need to overcome many of those same obstacles. Some ways to do this are by:

- Increasing education about the need to plan for long-term care. Many people don't know who pays for long-term care, and many don't care. Getting more people to understand that LTC risks are real and see the value in a product that insures against those risks has been a major challenge for the private industry. The CLASS program's marketing campaign may go a long way toward this endeavor.
- Moving away from Medicaid as the primary payer of long-term care. People don't plan to end up on Medicaid or to use it to fund long-term care. But when they don't plan and have an event that requires long-term care, they often end up on Medicaid either after spending down their assets or after doing some Medicaid planning to hide assets and qualify. The result is a system in which Medicaid is the primary payer rather than being a safety net. This issue is causing a serious problem to state budgets and needs to be addressed—potentially through policy changes that could get people to prepare for their LTC needs.
- Having more producers sell the product and offer products that are better tailored to needs will help to get more people to plan. Continued product innovation will help ensure product sustainability and enhance affordability.
- Enacting tax incentives also could help get more people to prepare and would likely save Medicaid money in the long term.

What improvements could be made to the CLASS Act to expand the accessibility of private long-term care plans?

Most carriers are taking a wait-and-see approach as to how the final program will look. As it is currently designed, carriers may be able to offer some supplemental coverage (such as a $50-per-day deductible). But in most cases, companies likely will compete against the CLASS Act by attempting to offer coverage for less—at least to healthy, married individuals. The $50-per-day average benefit might allow an individual to purchase coverage on top of the $50, but this only makes sense if CLASS Act premiums are lower than those in the private market. With the potential adverse selection in the CLASS Act, that will be difficult under the current structure.

The CLASS Act could be changed to offer a plan that the private market can better supplement or complement. Alignment of benefit triggers (not necessarily the same benefit triggers) and alignment of plan design (a lifetime benefit does not leave much room for a supplement) could be considered.

While the industry may get a boost from CLASS marketing (if done well), the CLASS Act also needs to get a boost from employers and long-term care insurance agents by having them tell their clients, "This combination of a private plan and CLASS is a good solution for your LTC risks." To get that kind of cooperation, the products must be designed to work together.

Should long-term care coverage be tied to employment (such as in the CLASS design or group coverage)? What are the pros and cons of this approach?

Group LTC insurance has been relatively successful in the private market. Selling through employers gets people to purchase earlier and at a younger age. And planning for long-term care at a younger age makes it easier to shoulder the burden financially. It can be an administrative burden for some employers, however, which is one of the challenges the CLASS Act faces. Setting up payroll deduction, validating monthly fees, communicating changes in employment status, and providing information to allow marketing activities all provide for an administrative burden that employers may decline to participate in.

Attendees greet Lane West (right) and Ethan Kra (far right) at the conclusion of their Capitol Hill briefing.

expense risk, and interest rate risk. Other threats include timing of retirement (see right), not saving enough, not saving early enough, leakage from defined contribution (DC) plans when employees roll over savings into an IRA, and being out of the work force during a portion of one's prime earning years.

Both defined benefit and, to a lesser extent, DC retirement plans allow pooling of risk, thus better leveraging of resources, West said. When you spread the risk over a group of individuals, he explained, "the group can plan collectively for the average outcome."

The advantage? "Factoring in mortality and interest rates," West said, "you need about 37 percent more money to self-insure than if you pool it."

"Public policy should work to promote lifetime income" and not simply promote a level of income to last a retiree only to life expectancy, Kra added.

Effective public policy reforms that could achieve that goal include:

- Providing incentives for workers to increase retirement savings;
- Discouraging lump sum distributions from DC plans and encouraging annuitization of lump sum distributions;
- Penalizing leakage of funds at the time of DC rollovers or even mandating rollovers;
- Supporting pooling of risk;
- Promoting lifetime income arrangements such as annuities.

Other reforms should look at ways to encourage workers to continue their careers past age 65. Kra said within the tax code, "marker issues" need to be addressed. These include an age for required distributions that is set at not later than 70-1/2 and no sooner than 59-1/2. These have not been increased or indexed for more than 30 years—while life expectancy has continued to increase.

"We should be encouraging private pensions and retirement savings plans to supplement the federal programs and [encouraging] employees to save," Kra said. "There should be enough income from Social Security, the plans, and savings that when people are unable to work, they have enough to provide for themselves."

Kra said other improvements to the tax code, particularly Section 401(a)(9), can be made to help encourage workers to purchase longevity insurance, which provides a benefit to those who live beyond age 85. He said that as regulations are currently written, pension plan participants cannot purchase longevity coverage in tax-qualified plans or individual retirement accounts because of minimum distribution requirements.

Slides of the briefing are available on the Academy's website. A video of the session can be viewed on the Academy's YouTube channel.

What a Difference a Year Makes

Kra and West offered a hypothetical example to demonstrate timing risk. In their illustration, a worker who delayed retirement for one year to retire on Jan. 1, 2009, lost more than 20 percent of his or her retirement account balance because of the 2008 market downturn. That, combined with higher annuity purchase rates as a result of the decline in interest rates during 2008, meant the worker would lose about $24,100 in annual benefits from an annuity—a 26 percent reduction in lifetime income.

*Retirement balance on Jan. 1, 2008: $1,000,000	Retirement balance on Jan. 1, 2008: $1,000,000
Retirement date: Jan. 1, 2008	Retirement date: Jan. 2009
Retirement balance on retirement date: $1,000,000	Retirement balance on retirement date: <$800,000
Purchase an annuity with annual benefit of: $92,800	Purchase an annuity with annual benefit of: $68,700

*Assumes that the account is invested 60/40 in equities (S&P 500/Lehman Aggregate Bond Index, now known as the Barclays Capital Aggregate Bond Index). For more information, see the presentation "Pension Risk and Your Retirement" (slide 14).

HILL BRIEFING VIDEO & SLIDES

Experts address risk in today's retirement plans.

Now available: Video (4-part series) and presentation slides of the April 4 Capitol Hill briefing, **Pension Risk and Your Retirement: Understanding Retirement Risk and Overcoming Challenges through Public Policy Options**.

Learn what risks are inherent with retirement plan designs and the implications for retirement planning and public policy reforms from pension experts Ethan Kra and Lane West. Ethan and Lane, members of the Academy's Pension Practice Council, also presented possible public policy reforms to reduce these risks.

Videos: www.youtube.com/user/ActuaryDotOrg

Slides: www.actuary.org/pension.asp

American Academy of Actuaries

Experts Seek Retirement Solutions

THE REASONS FOR THE DECLINE of defined benefit (DB) plans have been debated for years. But at the 36th Annual Enrolled Actuaries Meeting, the focus was on what the actuarial profession can do to reinvigorate DB plans. The meeting, jointly sponsored by the Academy and the Conference of Consulting Actuaries, took place March 27-30 in Washington.

"Without a major shift in retirement policy, corporate defined benefit plans will continue to disappear," said Lance Weiss, moderator of one of the meeting's three general sessions. "As representatives for the retirement community, what is the actuarial profession doing to stave off the extinction of defined benefit plans?"

Kenneth Porter, an enrolled actuary at the American Benefits Council, offered an overview of why so many plan sponsors have migrated to defined contribution (DC) plans. With some notable exceptions, the majority of DB plans did quite well before the Employee Retirement Income Security Act (ERISA), Porter said. These exceptions led Congress to pass ERISA in 1974 in an effort to control funding methods and change how plans are administered. The new strictures, however, caused employers in certain sectors of the marketplace to move away from DB plans.

While underfunded plans were the norm before ERISA, there has been a growing intolerance for underfunded plans in recent years, Porter said. Congress passed the Pension Protection Act of 2006 (PPA) to solve the underfunding problem with accounting, but these efforts were overturned by countercyclical economics.

"For many employers, PPA became the final straw," Porter explained, adding that the threat of shareholder litigation became a concern. Although lawsuits have not yet materialized, members of the business community are concerned that overfunding could result in a permanent surplus in pension funds and deplete shareholder value—resulting in litigation.

Mike Clark, an enrolled actuary at the Principal Financial Group, described ERISA as a suit designed for a different decade. It "pinches and binds so much that employers can think of nothing more than how to get out of it," he said.

Panelists speaking at the Pension Symposium included, from left, Frank Todisco, Ken Porter, Dave Gustafson, Mike Clark, and Ilana Boivie.

"What we have today are very thoroughly thought-out rules for funding and allocating assets for a plan that nobody wants to have," Clark said. "If voluntary sponsorship of DB plans is to be saved, our focus must change from the regulation of plans that we assume to exist to the encouragement of plans that we would like to exist through less regulation."

The country needs a retirement system that improves the lives of American retirees by leveraging the fact that employers behave in their own self-interest, Clark said. A company must receive a benefit that serves its ultimate goal in exchange for the financial risk that it takes to sponsor a DB plan.

Tom Finnegan, a principal at the Savitz Organization, closed the session by talking about ways to reinvigorate the DB system. For any new plan to be successful, he said, it must appeal to plan sponsors, plan participants, and Congress.

"We must show each of these groups that a new defined benefit plan is better, at least in some situations, than a defined contribution plan," Finnegan said.

For plan sponsors, he explained, that means incorporating risk-sharing into the design of the plan. Plan participants must be educated, he continued, so that they understand that DB plans offer a measurable increase in security. And to be acceptable to Congress, any allowable design must provide participants with a predictable, secure lifetime income. For more on the value of DB pension plans, see the Academy's issue brief.

Public Plans Debate

In the EA meeting's second general session, a panel of experts debated whether the current furor over the funding of public pen-

➜ CONTINUED ON **PAGE 7**

JBEA ISSUES FINAL REGS

The Joint Board for the Enrollment of Actuaries announced at the Enrolled Actuaries Meeting on March 30 that it had issued the final regulations establishing standards and qualifications for actuaries serving employee benefit plans covered by the Employee Retirement Income Security Act (ERISA). The new regulations set forth a number of key changes to continuing professional educational (CPE) requirements, including reducing the number of core CPE credits required after initial enrollment renewal from 18 to 12.

Starting From Scratch

After the 2011 Enrolled Actuaries Meeting, 48 actuaries gathered at the Pension Symposium on March 30-31 to brainstorm ways to strengthen national retirement security.

In past years, expert practitioners from outside the profession spoke to Pension Symposium attendees about the causes for the decline of defined benefit (DB) plans. This year, symposium panelists were primarily pension actuaries, and they went back to square one, fielding ideas to design a new private retirement system from scratch.

The symposium featured four discussion sessions:

- The causes of the demise of DB plans—and what lessons we can learn;
- The Society of Actuaries' Retirement 20/20 initiative and the ideas that emerged from the 2010 call for models;
- The Academy's Retirement for the Ages initiative and the key principles that the Academy has under consideration; and
- The profession's research, policy, and advocacy initiatives that are focused on the challenge of retirement security.

In their discussion, most symposium participants agreed that there is little likelihood of legislative action on retirement reform before the 2012 elections. "That gives us time to crystallize our views and develop some well-thought-out models," said one attendee.

Attendees debated how any new model should be presented to Congress. Because of concerns that neither party would support all the elements in a particular model, participants suggested it might be easier to solicit support for individual reform elements—such as raising the retirement age or allowing plan participants to purchase annuities with pretax dollars.

sions is a direct consequence of a severe cyclical budgetary shortfall or because of differences in accounting methods.

Economist Andrew Biggs, a resident scholar at the American Enterprise Institute in Washington, questioned what it means for a public-sector pension to be fully funded, adding that he believes that current Governmental Accounting Standards Board (GASB) rules and the market value of liabilities (MVL) approach espoused by financial economists are measuring different things.

Biggs said that the current GASB rules indicate how much of a contribution is necessary to have a greater than 50 percent expectation that the obligation will be paid. He said that the MVL approach would ask the question, "Is funding at 50 percent probability of meeting your obligation sufficient when you have to pay the obligation with 100 percent probability?"

Biggs said that most financial economists favor changing public pension accounting methods because they believe that an assumed discount rate should be based on the value of a pension plan's liabilities and not the value of its invested assets used to fund the liability. This ensures, he said, that "if you have a guaranteed benefit, then you could count yourself fully funded if you are able to pay the benefit with full certainty [100 percent]."

Elizabeth McNichol, a senior fellow specializing in state fiscal issues at the Center on Budget and Policy Priorities in Washington, countered that some of the solutions that policymakers have proposed for funding shortfalls in state and local public pension plans would worsen the states' long-term fiscal picture. These proposals—such as permitting states to declare bankruptcy or preventing them from issuing tax-exempt bonds if they refuse to change their pension accounting methods—would undermine their ability to invest in infrastructure, and fund education, health care, and other human services, McNichol said.

Municipalities should avoid adopting pension financing rules that create wide fluctuations in mandatory pension contributions, cautioned Keith Brainard, a research director at the National Association of State Retirement Administrators. He said that similar rules enacted under the PPA created the financial uncertainty that caused many employers to freeze or terminate their DB plans.

Professionalism Dilemmas

Moving from the global to the particular, the opening general session of the meeting featured a lively discussion on how to apply the Code of Professional Conduct in everyday pension practice. Through the use of three real-life case studies, panelists David Godofsky, Paul Zeisler, and Carol Sears tackled the question of whether the Code of Professional Conduct covers nonactuarial services.

"When you are approaching any situation upon which your actuarial valuation relies, you are acting as an actuary," said Sears, who was chairperson of the Actuarial Board for Counseling and Discipline (ABCD) in 2010. Actuaries have three tools to guide their actions, she said: The Code of Professional Conduct, the Qualification Standards, and the actuarial standards of practice, which are embedded in the Code of Conduct by virtue of Precept 3.

If you are still unclear about what to do, Sears reminded attendees, you can contact members of the ABCD and ask for guidance.

ASOP No. 41 Webinar Sets Record

THE MARCH 23 WEBINAR on the revised Actuarial Standard of Practice (ASOP) No. 41, *Actuarial Communications*, drew one of the largest crowds ever for a professionalism webinar. Approximately 8,000 actuaries—1,000 paid registrants with an average eight attendees at each site—tuned in to listen to Al Beer, chairperson of the Actuarial Standards Board (ASB), and ASB member Jim Murphy discuss the standard that takes effect on May 1. The webinar, which was sponsored by the Academy and co-sponsored by the American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries, attracted actuaries from all practice areas interested in learning how the standard will apply to communications between actuaries and their intended users.

Notable changes in the revised standard include how "actuarial communication" and "actuarial report" are defined, as well as how disclosure and deviations are treated, Beer and Murphy explained.

In the revised ASOP, actuarial communication is defined as "a written, electronic, or oral communication issued by an actuary with respect to actuarial services." This could include various types of communications, Murphy said, such as an email or a presentation.

The definition of an actuarial report also has changed. It isn't necessarily a single formal document, said Murphy, but it is a "set of actuarial documents that the actuary determines to be relevant to specific actuarial findings that is available to an intended user." Actuarial communication has become an ongoing, interactive process, he explained, and parts of the picture may be communicated at different times and in various forms. ASOP No. 41 directs the actuary to identify all applicable documents used to satisfy the disclosure requirements of an actuarial report.

"The essence of ASOP No. 41 is really disclosure," said Murphy. The standard makes it clear that the actuary is responsible for all actuarial assumptions and methods used in producing the actuarial communication, unless he or she discloses otherwise. Actuaries sometimes are required to use assumptions or methods specified by statutes or regulations, he noted, but if an actuary disagrees with an assumption or the method specified, he or she must disclose that fact either as part of the actuarial report or in a separate communication, such as a cover letter to the principal.

Jim Murphy, left, and Al Beer field questions from webinar listeners.

"ASOP No. 41 also standardizes the deviation clause," said Murphy. The deviation clause covers what actuaries should do if, in their professional judgment, they deviate from the guidance of a standard. Section 4.4 of ASOP No. 41 states that an actuary "can still comply with that ASOP by providing an appropriate statement in the actuarial communication with respect to the nature, rationale, and effect of such deviation."

The deviation clause allows actuaries to do what they believe to be best—as long as they disclose what they did, why they did it, and what the effect will be, Beer said.

After reviewing the standard, Beer and Murphy fielded a number of queries submitted by webinar attendees. They also suggested that those who have further questions about the application of the standard should seek the guidance of the Actuarial Board for Counseling and Discipline.

If you missed the webinar, you can download the slide presentation, as well as an audio recording, from the Academy's website.

Insurance Contracts Project Update

May 10 Webinar, Noon - 1:15 p.m. EDT

This live webinar will update attendees on the progress the International Accounting Standards Board and Financial Accounting Standards Board have made toward completing the Insurance Contracts project. It is the third in a series about the efforts to implement the international financial reporting standards. Presenters from the Academy's Insurance Accounting Standards Task Force will cover risk and composite margins, discount rates, acquisition costs, and unbundling.

Click here to learn more or to register.

Submit Your Nominations

Led by Chairperson John Parks, the Academy's penultimate past president, the Nominating Committee is seeking nominations for three regular director positions on the Academy Board of Directors. You can participate in the process by recommending an Academy member, or members, whose leadership and vision would be an asset to the board. To submit your nominations or to nominate yourself, go to www.actuary.org/nomination.asp. The board of directors' review of the nomination and election process is proceeding as a continuation of the discussions about and recommendations of the Governance Task Force. Changes are likely to be made to the 2011 elections to enhance participation. But these changes will not suspend this nominating process. Look for updates via email blasts and announcements on the Academy website.

Work Continues on Solvency Modernization

THE ACADEMY'S Jan. 31 report on the National Association of Insurance Commissioners' (NAIC) risk-based capital (RBC) formulas was a hot topic at the March 26-29 NAIC spring meeting in Austin, Texas.

Donna Novak, chairperson of the Academy's Health Solvency Work Group, Alex Krutov, chairperson of the Academy's Property and Casualty RBC Committee, and Nancy Bennett, the Academy's senior life fellow, presented the Academy's report to the NAIC's Solvency Modernization Initiative (SMI) RBC Subgroup, gave a brief synopsis of each practice area as it pertains to RBC, and answered questions from members of the subgroup. The report addressed intended or expected safety levels for RBC in the aggregate for the original life, health, and property and casualty RBC formulas. It also identified issues that still need to be resolved, including calibration and covariance within the RBC formulas, risks that could be quantified more accurately in the RBC formulas, and risks that could be included.

In other action, the NAIC's Professional Health Insurance Advisors (EX) Task Force held a hearing to solicit comments from interested parties on how the medical loss ratio (MLR) requirements of the Affordable Care Act (ACA) affect health insurance brokers/agents, insurance consumers, and insurance markets. Consumer groups, insurance companies, and groups representing agents testified at the March 27 hearing.

Following the hearing, the task force asked the NAIC's Health Care Actuarial Working Group and the Financial Condition (E) Committee to collect, analyze, and report on relevant data regarding the level of commissions and other payments to producers in the individual, small, and large group markets. They also were asked to evaluate the 2010 gross commissions or fee payments as a portion of the denominator of the MLR. The NAIC groups were asked to identify options to modify MLR definitions, methodology, and numerical standards that may be necessary to protect health insurance consumers and preserve the role of producers in the transaction of health insurance and in the resolution of disputed health insurance claims. The findings of the two groups will be submitted before the summer NAIC meeting.

The NAIC's Regulatory Framework (B) Task Force agreed to develop a comprehensive model act based on provisions in the ACA. The model act will include the ACA's 2014 individual and group market reform provisions, as well as those provisions that became effective on Sept. 23, 2010. NAIC staff will develop a work plan for completing this step by the end of the year. The task force also plans to develop model language for some of the 2014 market provisions in ACA and compile a list of existing NAIC models that are affected by ACA and indicate which models need to be revised.

The NAIC's Health Actuarial Task Force asked the Academy to form a work group to develop a valuation table based on a 2008 group long-term disability experience table commissioned by the Society of Actuaries. This table would replace the 1987 Commissioner's Group Disability Table. The goal is to have the table completed by the NAIC's fall meeting in November.

Warren Jones, chairperson of the Academy's State Long-Term Care Task Force, reported on the progress of three Academy long-term care work groups: the Academy/SOA Long-Term Care Valuation Work Group, the Long-Term Care Principle-based Work Group, and the newly formed Long-Term Care Practice Note Work Group. Jones said that the Long-Term Care Valuation Work Group expects to complete the valuation table it is creating by June 2012, the Long-Term Care Principle-based Work Group plans to issue a report on its work by the end of this year, and the Long-Term Care Practice Note Work Group expects to finish updating the 2003 long-term care rate stability practice note by the end of this year as well.

Shari Westerfield, chairperson of the Academy's Committee on State Health Issues, provided an update on the Academy's health care reform activities. Her report came in response to a request from the regulators to get a sense of the health care reform work the Academy has done, as well as the Academy's current projects and those planned for the future.

Property and Casualty Action

Lisa Slotznick, a member of the Academy's Committee on Property and Liability Financial Reporting, presented proposed revisions of statement of actuarial opinion (SAO) instructions to the NAIC's Casualty Actuarial and Statistical Task Force. Slotznick told the task force that the revisions were motivated by changes to the Casualty Actuarial Society (CAS) syllabus that are effective this year and reflect the Casualty Practice Council's view that the responsibility falls on the individual actuary to ensure that he or she meets the Qualification Standards.

This sparked a general discussion about the instructions from regulators, who also expressed concern about the quality of opinions. The task force may reactivate a now-dormant opinion subgroup to consider the Academy's proposal and possibly make other changes to the instructions. Further discussion of the proposal, however, was deferred until the task force's regulator-to-regulator call on May 24. The Academy's recommendations could still be considered, along with other instruction revisions, at the summer NAIC meeting. Regulators noted that the repeal of Actuarial Standard of Practice (ASOP) No. 9, *Documentation and Disclosure in Property and Casualty Insurance Ratemaking, Loss Reserving, and Valuations,* will necessitate further changes to the instructions.

The new format for a risk classification survey instrument was discussed during the NAIC's Property and Casualty Insurance Committee meeting. The survey uses 21 examples to extract information from insurance companies regarding the manner in which various types of insureds are treated in different risk classification categories. The intent of the exercise is to identify the range of variables at work in risk classification. States have discretion to choose whether to issue the survey to their domiciliary insurance companies and what to do with the results if they decide to do so.

Life Action

Mary Bahna-Nolan, chairperson of the Life Experience Subcommittee, updated members of the NAIC's Life Actuarial Task Force

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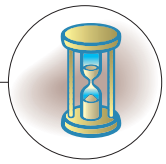
Life News

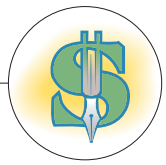


Embedded Values Practice Note

THE ACADEMY'S LIFE FINANCIAL REPORTING COMMITTEE has released a practice note on common practices in performing market-consistent embedded value (MCEV) calculations as governed by CFO Forum principles published in June 2008. The CFO Forum is a discussion group composed of the chief financial officers of major European insurance companies. The new document updates an earlier practice note that discusses requirements laid out by the CFO Forum in 2004.

The practice note, *Market Consistent Embedded Values*, provides background on MCEV, points out the principal differences between MCEV and other calculations, such as total embedded value and European embedded value, and reviews MCEV formulas and mechanics. It also identifies MCEV disclosure requirements, as well as the assumptions required for MCEV calculations and for calculating the value and the effect hedging has on future options. Non-hedgeable risks, their quantified costs, and their costs included in MCEV, also are discussed in the paper.

Risk Management & Financial Reporting News



Reporting Risk and Solvency

THE ACADEMY'S ERM COMMITTEE submitted comments on March 18 to the National Association of Insurance Commissioners' (NAIC) International Solvency (EX) Working Group in response to its draft proposal *U.S. Own Risk and Solvency Assessment* (ORSA).

The introduction of an ORSA requirement into the U.S. solvency framework could provide regulators with meaningful insights into a company's risk management practices, Maryellen Coggins, chairperson of the ERM Committee, wrote in the letter. She also cautioned that "overly onerous or standardized reporting requirements will likely make the information less valuable to the regulators."

The letter states that the proposed U.S. ORSA regulatory requirements could be challenging for many insurers regardless of their size, and suggests that NAIC consider requiring insurers to provide a comprehensive initial report of the results of their ORSA, and then file subsequent reports based on material changes only. The letter also includes a number of specific comments on sections of the exposure draft.

NAIC Meeting, continued from Page 9

on the development of a new payout annuity mortality table. She reported that the basic table, a projection scale, and a margin were released for comment, and that work is continuing on the development of mortality tables for pre-need, simplified issue, and guaranteed life insurance.

John MacBain, chairperson of the Academy's Nonforfeiture Improvement Work Group, reported on public policy issues that relate to minimum nonforfeiture requirements. He said that he expects to present the full report on nonforfeiture improvement at the NAIC summer meeting in August.

The NAIC's Life Insurance and Annuities (A) Committee adopted the insurer bulletin on stranger-originated annuity (STOA) transactions. The (A) Committee also released a draft of the Annuity Disclosure Model Regulation, which was written with extensive input from the Academy's Annuity Illustration Work Group.

Risk Management and Financial Reporting Action

The NAIC's Statutory Accounting Principles Working Group provided an update on its work on deferred tax assets (DTA) to the NAIC's Capital Adequacy Task Force. The Academy's DTA Bridge Group, which submitted a final report to the NAIC in December, may need to monitor the asset limitations in relation to the risk-based capital treatment once the accounting guidance is finalized. Dale Bruggeman, chairperson of the NAIC's DTA subgroup, said this was because the guidance might affect accounting and the balance sheet.

Maryellen Coggins, chairperson of the Academy's ERM Committee, told the NAIC's International Solvency Working Group that the NAIC should allow pooled reporting for members of intercompany pools since the risk profile of these entities would not differ by insurance legal entity. Her remarks came as she presented the committee's comments on the NAIC paper *U.S. Own Risk and Solvency Assessment (ORSA) Proposal* (see story above). During the meeting, the working group announced that governance principles will be discussed at an interim meeting on enterprise risk management (ERM) to be held in conjunction with the NAIC's Corporate Governance Working Group meeting in late May or June. In the interim, the solvency working group will hear a presentation from an independent organization that represents chief risk officers, conduct ERM workshops, and discuss current international risk solvency assessment activity.

—Tina Getachew, Tim Mahoney, John Meetz, and Lauren Pachman

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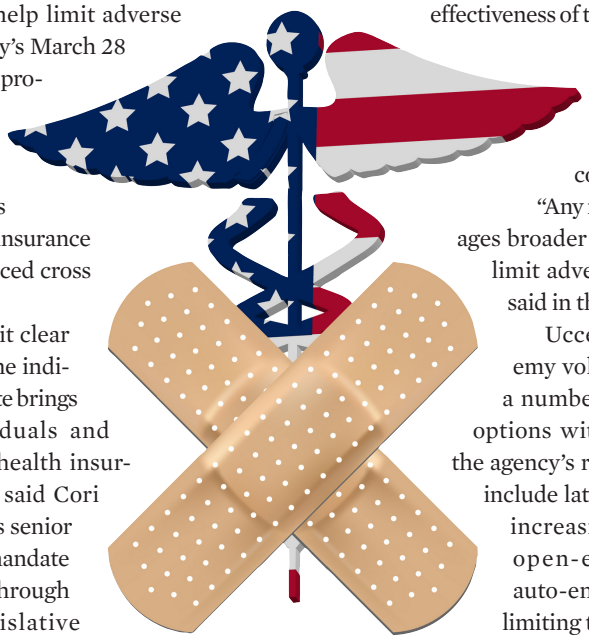
Mandate Options Considered

IF THE INDIVIDUAL health insurance coverage mandate contained within the Affordable Care Act is removed from the law, the Academy warned in a recent statement, policymakers will need to enact alternatives to help limit adverse selection. The Academy's March 28 statement explains that provisions that eliminate exclusions and restrict rating for pre-existing conditions require that the health insurance markets attract a balanced cross section of risks.



"We want to make it clear to policymakers that the individual coverage mandate brings in lower-risk individuals and ultimately keeps the health insurance markets viable," said Cori Uccello, the Academy's senior health fellow. "If the mandate is removed, whether through court action or legislative efforts, policymakers will have to provide alternatives."

The Academy statement was issued directly after the release of a new U.S. Government Accountability Office (GAO) report that explores possible alternatives to the individual mandate.

Throughout the health reform legislative process, the Academy urged Senate and congressional leaders to strengthen the individual mandate to help thwart adverse selection. Uccello said that the same tools that the Academy identified to improve the effectiveness of the mandate can serve as alternatives. If the mandate is not removed from the law, these tools should still be considered, she added.

"Any mechanism that encourages broader participation will help limit adverse selection," Uccello said in the March 28 statement.

Uccello and several Academy volunteers had discussed a number of alternative policy options with the GAO as part of the agency's research. These options include late-enrollment penalties, increasing the time between open-enrollment periods, auto-enrollment features, and limiting the ability to upgrade to more generous benefit plans during open enrollment.

Academy volunteers who provided input to the GAO for the report include Health Practice Council Vice President Tom Wildsmith, Committee on Federal Health Issues Chairperson Cathy Murphy-Barron, and Health Practice Council member David Shea.

Jarvis Farley Service Award

Nominations Sought

The Jarvis Farley Service Award is presented annually to a member whose efforts on behalf of the Academy have made significant contributions to the advancement of the actuarial profession. Nominations for the 2011 Farley Award are now being accepted.

With the exception of previous Farley Award recipients, any Academy member may be nominated. Past Academy presidents may be nominated, but only their post-presidential service will be considered.

For more information or to nominate a candidate, go to http://www.actuary.org/awards/farley.asp. Or contact Kasha Shelton, manager of membership operations, at 202-223-8196 or membership@actuary.org.

Nominations are due by July 12.