AMERICAN ACADEMY *of* ACTUARIES

ACADEMY ALERT

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2010 Academy Legislative/Regulatory Review

I. Introduction

This annual Academy legislative/regulatory year-in-review focuses on significant legislative and regulatory activities affecting the actuarial profession, as well as the Academy's work on these issues during the past year. A great deal of the Academy's efforts in 2010 focused on the passage and implementation of health care reform and financial services reform, as well as the National Association of Insurance Commissioners' (NAIC) principle-based approach to life reserves.

The Academy hosted its 2010 Summer Summit on July 19, focusing on its role in advocating in the public interest. Led by the Academy's Public Interest Committee, the 2010 Summit was designed to help develop a consensus among Academy leaders on what it means to advocate in the public interest and to strategize on the specific issues on which the Academy can and should advocate a position. Lifetime income and Medicare sustainability were among the issues that generated the most interest from attendees.

II. Major Issues

Health Care Reform

President Obama signed the Patient Protection and Affordable Care Act (PPACA) [Pub.L. 111-148] into law on March 23. Several adjustments to PPACA were included in the Health Care and Education Reconciliation Act (Pub. L. 111-152), which the President signed into law on March 30. These laws together have become known as the Affordable Care Act (ACA). The ACA introduces a number of insurance market reforms, imposes an individual mandate, creates a new insurance exchange, provides subsidies for low- and middle-income individuals/families, expands Medicaid, and creates new programs that are intended to improve quality and address the rising cost of health care. Many of these provisions will not take effect until 2014.

Key provisions of ACA that went into effect within the first six months of enactment include:

- Requiring plans that offer dependent coverage to allow young adults to remain on their parents' plan until the age of 26;
- Prohibiting lifetime limits on benefits and restricting the use of annual limits;
- Prohibiting insurers from rescinding existing policies;
- Ensuring that all group and individual plans provide first-dollar coverage for preventive services;
- Eliminating pre-existing condition limitations for children, and providing uninsured adults with pre-existing conditions access to coverage through a temporary national high-risk pool;
- Providing tax credits for small businesses with fewer than 25 employees and average annual wages of up to $50,000; and
- Creating a temporary reinsurance program for early retirees.

Before the enactment of ACA, the Academy commented on the health care reform legislation and hosted a webinar on Jan. 25 that offered an overview of the then-current status of health care reform to more than 1,500 Academy members. Health Practice Council panelists David Shea, Tom Wildsmith, and Cori Uccello outlined significant differences between the House and Senate bills and discussed the Academy's interaction with policymakers, the media, and other interested parties in the debate. The slides and archived webinar are available online. The webinar was co-sponsored by the Conference of Consulting Actuaries and the Society of Actuaries.

Following the enactment of ACA, the Academy turned its attention to the regulatory phase. The Health Practice Council established a number of work groups charged with identifying areas in the law that need clarification through regulation and developed comments on various provisions for submission to the Department of Health and Human Services (HHS), the NAIC, and other relevant organizations. Separate work groups were created to address the following issues:

- Medical loss ratio reporting and rebates;
- Near-term benefit and eligibility changes (e.g., prohibition of lifetime benefits, extension of dependent coverage, and guaranteed issue for children);
- Grandfathered plans;
- Creation of a premium review process;
- Establishment of a temporary high risk pool;
- Creation of a temporary reinsurance program for early retirees; and
- Creation of a voluntary long-term care services program (the CLASS Act).

In addition to the creation of these new work groups, the Health Practice Council launched a new webpage—*Actuarial Compass: Navigating Health Reform Implementation*—as a means for tracking new developments, detailing important terms and definitions in the new law, and highlighting the practice council's work. The Academy's *Critical Issues in Health Reform* series and other documents related to the health care reform dialogue remain available on the Health Reform Now page. The Academy also continues to publish *HealthCheck*, the Academy's bi-weekly e-newsletter that keeps members apprised of Academy activity, legislative updates, and media coverage related to health care reform. All ACA-related letters and public statements can be found on the *Actuarial Compass* webpage.

The Academy's Medical Loss Ratio Regulation (MLR) Work Group sent 10 comment letters over an eight-month period to both HHS and the NAIC. In addition to providing input in response to an initial HHS request for information, the letters addressed various aspects of the new MLR reporting and rebate requirements in ACA, including credibility adjustments, contract reserves, the proposed financial reporting blank, and the potential for market disruption.

The Premium Review Work Group also has been active since the implementation of ACA. The group has written several comment letters to HHS and the NAIC, primarily addressing and evaluating the options for defining an "unreasonable" rate increase. The group responded to the request for information from HHS on the rate review provision in ACA, offering initial thoughts on defining an unreasonable increase, as well as commenting on the current process for filing and reviewing premium rates. The group also commented to the NAIC on the proposed rate filing disclosure form.

The Academy was referenced specifically in ACA and tasked with providing input to HHS on the temporary reinsurance program (Section 1341). In response, the Academy's newly created Risk Sharing Work Group, which is charged with addressing all risk-sharing components in ACA, sent a comment letter to HHS with input on potential approaches for identifying high-risk individuals and determining reinsurance payments. Members of the work group continue to have conversations with HHS officials about issues discussed in the comment letter. While not directly related to the provisions in ACA, the Health Practice Council also released an issue brief, *Risk Assessment and Risk Adjustment*, which provides an overview of risk adjustment, outlines how it currently is used in the health care industry, and discusses general issues to consider when determining how to implement a risk adjustment program.

Many of the Academy's new implementation groups worked quickly to respond to interim final regulations (IFRs) for those provisions that were scheduled to take effect within six months of the ACA's enactment. The Benefit and Eligibility Changes Work Group provided comments on the IFRs on first-dollar coverage for preventive services, the elimination of preexisting condition exclusions for children younger than 19, the elimination of lifetime limits and restrictions on annual limits, and the extension of dependent coverage to age 26. The Grandfathering Provisions Work Group responded to the IFR that addressed the status of health insurance coverage as a grandfathered plan. The Exchanges Work Group responded to a request for comments from HHS on the exchange-related provisions in Title 1 of ACA. The letter included responses to questions about qualified health plans, actuarial value, increasing and facilitating participation in the exchanges, enrollment and eligibility, quality standards, and risk adjustment.

The Joint Committee on Retiree Health provided comments to HHS on the early retiree reinsurance program created by ACA. The committee offered comments on the definition of "early retiree," data requirements, the two-year reinsurance estimate, pharmacy rebates, cost-sharing payment documentation, and the allocation of funding.

In addition to submitting comment letters, members of the health reform implementation work groups have had conversations with HHS representatives, senior White House officials, the Government Accountability Office (GAO), and congressional staff on a variety of topics, including medical loss ratios, rate review, the temporary reinsurance program, many of the near-term benefit and eligibility changes, and the repeal of the tax deduction for retiree drug subsidies.

Financial Services Reform

President Obama signed H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203), into law on July 21. This landmark financial services overhaul legislation is one of the president's key policy initiatives. The law:

- Establishes the Financial Stability Oversight Council to monitor large financial companies and break up large companies that pose significant systemic risk to the financial system;
- Establishes the Federal Insurance Office (FIO) within the Department of the Treasury to monitor the insurance industry and provide Congress and the administration with insurance expertise and recommendations for policy changes;
- Creates an independent Consumer Financial Protection Bureau within the Federal Reserve to monitor financial products sold to consumers; and
- Repeals the prohibition against regulation of a security-based swap agreement and prohibits a security-based swap from being regulated under state law as an insurance contract.

As part of the response to the impending financial services reform legislation, the Academy's Financial Regulatory Reform Task Force urged Congress on June 9, as it attempted to reconcile H.R.4173 and S.3217, to include an Office of the Chief Actuary in the Office of Financial Research.

On a related issue, the Financial Regulatory Reform Task Force released in May a public policy white paper, *Role of the Systemic Risk Regulator*. The white paper outlines new key functions necessary for effective systemic risk regulation.

In addition, speakers from the Academy's Financial Regulatory Reform Task Force presented an Oct. 5 webinar providing an overview of the Dodd-Frank Act. Presenters detailed components of the law that will affect the insurance industry and reviewed the work the Academy has completed related to the law and its implementation. The Academy earlier held an April 20 webinar that outlined federal regulatory responses to the financial crisis and their potential effects on the life and casualty insurance industry. Panelists discussed proposals for modernizing financial services regulation and examined reactions to the proposals from Congress, the NAIC, and the Academy. Slides from the webinar can be found here.

PBA: Standard Valuation Law and Valuation Manual

The Academy has been instrumental in efforts to modernize the framework for determining life insurers' statutory required capital and reserves. The principle-based approach (PBA) to reserves and capital uses risk analysis and risk-management techniques to capture underlying life insurance and annuity risks more accurately than the current rule-based, one-size-fits-all approach.

The NAIC adopted the revised Standard Valuation Law in September 2009 and at its Summer 2010 National Meeting, the NAIC's Life and Health Actuarial Task Force (LHATF) exposed for comment a new draft of section VM-20, the principle-based reserve requirements for life products, of its valuation manual. This exposure draft represents the culmination of six years of work by the Academy, regulators, and industry in the design and implementation of a principle-based approach to calculating reserves. This exposure draft of VM-20 will serve as the basis for developing metrics for the field testing/impact study, which has already begun.

The Academy also has submitted many comment letters, reports, and amendment proposals to the NAIC relating to VM-20. These include:

- A report, submitted in September by the Academy's Variable Universal Life Subgroup of the Life Reserves Work Group (LRWG) to the NAIC VM PBR Life Subgroup on the impact that different return path options have on the principle-based deterministic reserve calculation required by VM-20.
- Amendment proposals to VM-20 on consistent simplification, scenario reduction, the stochastic exclusion test and supplemental information on the reinvestment spread proposal that were sent to LHATF in July.
- An LRWG amendment proposal to VM-20 on margin ratios that was sent in June to LHATF.
- An amendment proposal to VM-20 to modify requirements for prescribed reinvestment asset spreads that was sent to LHATF in June.
- A March survey to reinsurers about wording in VM-20, Section 8C, on the use of reinsurer mortality.
- A March Valuation Law Manual Team report to LHATF on practical considerations for policy reserves in VM-01 and VM-20.
- An amendment to VM-20 on the margin ratio with the accompanying theoretical foundation was sent to LHATF in March by the Life Reserves Work Group.

All Academy PBA and VM-20 letters and reports are available here.

The Academy and the SOA conducted a Sept. 22 seminar, *PBA Implementation: Getting a Rock Solid Start*, in Chicago that offered implementation insights to help companies prepare for the new principle-based requirements for life products in section VM-20. Earlier in the year, on May 19, the Academy held another PBA seminar, *How Will PBA Rock Your World?*. Post-NAIC PBA seminar presentations can be found here.

Lifetime Income Options for Retirement

Frank Todisco, the Academy's former Senior Pension Fellow, and Noel Abkemeier, a member of the Academy's Life Products Committee, testified on Sept. 15 before the Department of Labor (DOL) and the Department of the Treasury in a public hearing on lifetime income options for retirement. In their testimony, Todisco and Abkemeier recognized that lifetime income arrangements:

- Protect against longevity risk;

- Are economically efficient, since it is significantly less expensive to pool longevity risk through a lifetime income arrangement than to "self-insure" the risk by accumulating assets adequate to last until a very old age;
- Provide retirees with a budgeting signal to help protect against overspending;
- Help retirees avoid unnecessarily underspending out of fear of outliving their resources; and
- Reduce senior citizens' money management responsibilities at advanced ages, when they might be significantly less able to manage investments and finances.

Todisco submitted written testimony on behalf of the Academy on June 11 in conjunction with a hearing conducted by the Senate Special Committee on Aging on turning retirement savings into lifetime income. The testimony referred to the Academy's May 3 response to the joint DOL and Department of the Treasury Request for Information (RFI) regarding lifetime income options for participants and beneficiaries in retirement plans. Themes addressed in the RFI response and the written testimony for the Senate hearing included:

- The importance of addressing the longevity risks and other risks associated with an aging population that is increasingly dependent on individual account plans for retirement security;
- The risk management benefits of lifetime income options;
- The economic efficiency of lifetime income options;
- The importance of promoting education and financial literacy regarding retirement security issues;
- The benefits of incorporating the findings of behavioral finance into policy initiatives;
- The usefulness of encouraging multiple types of lifetime income options—including partial annuitization, refund guarantees, and deferrals to advanced ages—to fit the variety of individual circumstances; and
- Encouraging that some form of guaranteed lifetime income be one of the options offered in individual account plans, provided that such a requirement is accompanied by comprehensive, manageable regulations that permit plan sponsors, both large and small, to carry out such a requirement without exposure to excessive fiduciary risk.

III. Cross-Practice Issues

National Commission on Fiscal Responsibility and Reform

The National Commission on Fiscal Responsibility and Reform, which was created by President Obama on Feb. 18 and tasked with forging consensus on how to reduce budget deficits, failed to officially adopt its Dec. 1 proposal. The plan would have needed to receive 14 of the 18 panel members' votes to be adopted, which then would have required Congress to take up the plan for a vote.

The report recommended a freeze of the sustainable growth rate formula for determining Medicare physicians' payments through 2013 and adding a 1 percent cut in 2014; the repeal or reform of the Community Living Assistance Services and Supports Act (CLASS), which was included in the Affordable Care Act (ACA) and would provide long-term care through employers; the adoption of a budget for total health care spending that would limit growth to gross domestic product plus 1 percent beginning in 2020; and the expansion of powers of the Independent Payment Advisory Board (IPAB) created under the ACA so the IPAB would be allowed to make recommendations for the following: cost-sharing and benefit design, adjusting the federal-state responsibility for Medicaid, establishing a public option in exchanges, raising the Social Security retirement age, and moving toward some type of all-payer system.

The Academy's Public Interest Committee sent an Oct. 25 letter to the commission addressing the financial condition of the Social Security system and, more specifically, the potential for increasing the Social Security retirement age. The Academy's accompanying October issue brief on raising the retirement age for Social Security can be found here.

Deferred Tax Assets

At the request of the Capital Adequacy Task Force of the NAIC, the Academy undertook a project to consider the appropriate treatment of the deferred tax asset (DTA) in the risk-based capital (RBC) formulas for life, property/casualty, and health insurers. The Academy formed the Deferred Tax Asset Bridge Group (DTABG) to complete this work. In accordance with the NAIC's request, the DTABG also considered the issue both with and without regard to admissibility as an asset under statutory accounting.

The DTABG submitted a revised report on Dec. 13 to the NAIC. The report addressed comments provided by interested parties during the NAIC's exposure period. An earlier report had been submitted on Sept. 30. In the revised Dec. 13 report, the DTABG recommended that the NAIC consider the following approach to the RBC charge for the DTA:

- The RBC charge should reflect the company's level of capitalization, as measured by the RBC ratio calculated without the admitted DTA in adjusted capital (with certain other adjustments).
- The RBC charge should be placed in a portion of the RBC formula that is outside the covariance adjustment (C-0 for life, R-0 for P&C, and H-0 for health). It is important to note that, by placing the RBC charge outside of the covariance adjustment, it has a greater impact on the RBC result than if it were subject to the covariance adjustment.
- The amount of the RBC charge should eliminate the benefit of DTAs in excess of those recoverable from past taxes in calculating an RBC ratio for companies with an Ex-DTA RBC ratio less than 200 percent of ACL and should be floored at 0 percent or 1 percent, depending on the admissibility limits placed on the DTA, of the amount of DTA not supported by past taxes paid for companies with an Ex DTA RBC Ratio over percent:

  - If the full DTA less any valuation allowance (adjusted gross DTA) is admitted, the floor should be one percent.
  - If current (or similar) capping procedures are maintained, the floor should be zero percent, given the resulting implicit "RBC charge" of the capping procedures.

IV. Practice Council Issues

Casualty Practice Council

Medical Professional Liability

The Casualty Practice Council sent letters to congressional leaders in January and February in response to H.R. 3962 (an early version of the Affordable Care Act), warning that repealing the antitrust exemption for medical professional liability insurers could preclude data collection and aggregation across companies, which could limit competition and potentially increase premiums. The House passed a different bill, H.R. 4626, the Health Insurance Industry Fair Competition Act, on Feb. 24 that also would have repealed the antitrust exemption for medical professional liability insurers. The bill failed in the Senate, however, and was not included in the final health reform bill that President Obama signed into law.

Model Audit Rule Practice Note

A cross-practice area subgroup of the Committee on Property and Liability Financial Reporting (COPLFR) in November published the *Model Audit Rule Practice Note*, which is intended to assist actuaries when supporting management's assertions per the Model Audit Rule, as applied to the evaluation and testing of key controls for the actuarial balances, including loss reserves for the financial reporting process.

NFIP Extension

President Obama signed into law S. 3814 (Pub. L. 111-250) on Sept. 30, which extends the National Flood Insurance Program (NFIP) until Sept. 30, 2011.

The House passed a more expansive reform bill that would have reauthorized the NFIP through Sept. 30, 2015. H.R. 5114, the Flood Insurance Reform Priorities Act, would have postponed for five years the requirement for mandatory purchase of flood insurance by homeowners living in newly designated flood-hazard zones. The Senate conducted hearings to consider a long-term extension of the program, but did not act on the bill.

Oil Spill Liability

The Casualty Practice Council submitted written testimony on June 9 for the Senate Environment and Public Works Committee hearing on S. 3305, the "Big Oil Bailout Prevention Liability Act of 2010," which would have raised the statutory limit of liability of some entities that are responsible for oil spills from $75 million to $10 billion. The council concluded that the higher limits reflected in the proposed bill may serve as an incentive to strengthen risk management practices and reduce the likelihood and consequences of a similar event in the future, but the bill did not serve to enhance risk management practices. No action has been taken on the bill.

P/C Insurance Company Insolvency Report

The Academy's Property/Casualty Financial Soundness/Risk Management Committee published a report in September on the effects of loss reserve development in the P/C industry and the role that the development of losses plays in the insolvencies of P/C insurance companies. The committee's observations include:

- Many of the insolvent companies were small, relatively new, and mono-line and/or mono-state;
- Reasons for most of the insolvencies could be classified as poor management and/or decision making;
- Many of the opinions did not adequately disclose companies' major risk factors; and
- Risk-of-material-adverse-deviation (RMAD) disclosures were questionable.

Terrorism Risk Insurance

The Academy's Terrorism Risk Insurance Subgroup responded on Aug. 2 to a June 17 Federal Register request by the President's Working Group on Financial Markets for an analysis of the ongoing availability and affordability of terrorism risk insurance.

Key factors addressed in the letter included designing a federal framework for terrorism risk insurance for coverage to be widely and readily available, creating a federal backstop, having the ability to estimate the potential exposure to loss resulting from terrorism events, having the ability to obtain reasonable pricing of insurance to cover those events, and establishing the level of insurer/reinsurer capital for such coverage to be available.

Other issues addressed in the letter included economic factors; underwriting; coverage; policyholder demand; price of insurance; losses associated with chemical, nuclear, biological, and radiological (CNBR) acts; reinsurance, deductible and co-share levels; and the expiration date of the program.

Health Practice Council

Medicare Trustees Report

The Medicare Board of Trustees released its 2010 report on the financial status of the Medicare program on Aug. 5. With lower expenditures and additional tax revenues to be realized as a result of the passage of the Affordable Care Act earlier in the year, the exhaustion date for the Hospital Insurance (HI) trust fund assets is projected to be 2029, instead of 2017 as last year's report projected. HI expenditures will continue to exceed trust fund income for the next few years, but surpluses are projected beginning in 2014 and continuing through 2022 due to the savings expected under the new health care reform law.

In his statement of actuarial opinion, Richard Foster, chief actuary for the Centers for Medicare and Medicaid Services, clarified that some of the PPACA payment updates may not be viable in the long term, meaning that the financial projections in the 2010 report may not "represent a reasonable expectation for actual program operations" in the short or long range. Reflecting that clarification, the Office of the Actuary released an alternative illustrative scenario for projected Medicare expenditures.

For the fifth 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 triggered a Medicare excess general revenue funding warning, which requires the president to submit legislation addressing this shortfall to Congress within 15 days after submitting the fiscal year 2012 budget next year. The House in January 2009 eliminated the requirement for House legislative activity on the Medicare trigger for the duration of the 111th Congress. It is uncertain if the House will again eliminate the requirement in 2011.

The Health Practice Council in November updated its annual issue brief, *Medicare's Financial Condition: Beyond Actuarial Balance*, shortly after the Trustees' Report was issued.

Mental Health Parity

The departments of the Treasury, Labor, and Health and Human Services on Jan. 29 released interim final rules on the implementation of the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA) (Pub. L. 110-343), which took effect in October 2009. The final rules went into effect on April 5, and are generally applicable to group health insurance plans and issuers for years beginning on or after July 1. The Academy's Committee on Professionalism submitted a May 19 letter to the IRS in response to the rules. In the letter, the Committee addressed Section 512(a)(2)(c) and made a recommendation for what constitutes a "qualified actuary."

The 2008 law prohibits plans from establishing financial requirements, out-of-network coverage, and treatment requirements for mental health or substance abuse that are more restrictive than those available for medical and surgical benefits. Employers with fewer than 50 workers are exempted. Plans may request an exemption from the law if they can prove that compliance would increase their costs by two percent or more in the first year (one percent in subsequent years).

Medicare Physician's Payment Fix

President Obama on Dec. 16 signed into law H.R. 4994 (Pub. L. 111-309), which makes adjustments to the physician's payment formula and prevents a 25 percent cut to Medicare physician's payments from taking effect Jan. 1, 2011. The act will freeze current payment rates until Dec. 31, 2011. H.R. 4994 was the sixth extension of current Medicare rates in the last year.

EEOC Issues GINA Final Rule

The Equal Employment Opportunity Commission (EEOC) issued a final rule on Nov. 9 implementing Title II of the Genetic Information Nondiscrimination Act (GINA) (Pub.L. 110-233). Title II of GINA protects job applicants, current and former employees, labor union members, and apprentices and trainees from discrimination based on genetic information.

The regulations, which go into effect Jan. 10, 2011, prohibit employers from using genetic information in making employment decisions (including health benefits). Employers are prohibited from obtaining genetic information for an individual by performing a search on the Internet or listening to third-party conversations with the intent of obtaining genetic information.

If an employer makes a lawful request for health-related information for an individual, then the employer must warn the employee and/or the health care provider that genetic information must not be provided in the response to that request. If genetic information nevertheless is included in the response to that request, then the employer is required to maintain confidentiality of the genetic information and may not use that information as grounds for an employment decision.

Massachusetts H3447: Gender Rating for Disability Insurance

The Academy's State Health Committee submitted written testimony on Feb. 4 to the Massachusetts House and Senate Joint Committee on Financial Services regarding gender rating for disability insurance in Massachusetts House Bill 3447, which would provide for equitable coverage in disability policies. The Academy indicated that, in a voluntary market, prohibiting disability insurance premiums to vary by gender would require one subset of purchasers to subsidize another and could increase average premiums overall. The bill was referred to the Massachusetts House Committee on Rules on April 22, but has seen no further action.

North Carolina Proposal to Change the Definition of "Qualified Actuary"

The Academy's State Health Committee, along with the Council on Professionalism, submitted a April 14 comment letter to the North Carolina Department of Insurance in response to its proposal to change the definition in regulations of a "qualified actuary" from being an Academy member or a member of the Society of Actuaries to being a member of both organizations. The Academy groups concluded that the current definition of "qualified actuary" is preferable, reasoning that members of both organizations had to adhere to the same standards and that requiring dual membership would impose greater costs unnecessarily on actuaries.

Excessive Premium Increases

The Premium Review Work Group sent a letter on July 27 to the leadership of the Massachusetts legislature on Senate Bill 2447, which included a provision that would deem "excessive" any health insurance premium increase that exceeds 150 percent of the increase in the medical consumer price index (CPI). The work group's comments detailed some of the limitations of the medical CPI as a measure of the reasonableness of a premium increase.

This provision was modified in the final bill (S2585) signed into law (Mass. Gen. Laws Ch. 288, §§29-31, 2010) by Gov. Deval Patrick on Aug. 10. An "excessive" premium increase would now be based on several factors, including the carrier's contribution to surplus and the aggregate medical loss ratio.

Life Practice Council

NAIC Annuity Disclosure Model Regulation

The NAIC Annuity Disclosure Working Group in October approved the Annuity Disclosure Model Act with extensive input from the Academy's Annuity Illustration Work Group. The Life Insurance and Annuities (A) Committee subsequently submitted the model for an additional 30-day comment period for any suggestions not previously heard. The Academy submitted its most recent comment letter on Nov. 11.

Rule 151A

The Circuit Court of Appeals for the District of Columbia on July 12 voided the U.S. Securities and Exchange Commission's (SEC) Rule 151A, which would have classified indexed annuities as securities under the SEC's oversight. The court's ruling allows indexed annuities to continue to be classified as insurance products under state regulation. Issued in January 2009, Rule 151A was scheduled for implementation by Jan. 12, 2011. The court's opinion in *American Equity Investment Life Insurance Company v. SEC* is available here.

On a related matter, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203) classifies indexed annuities as state-regulated insurance products governed by standards developed by the NAIC.

Stranger Originated Annuities (STOAs)

The National Council of Insurance Legislators (NCOIL) Life Insurance and Financial Planning Committee in November appointed a subcommittee to study the issue of Stranger Originated Annuities (STOAs). The subcommittee plans to report on the issue at the next National Conference of Insurance Legislators (NCOIL) meeting in March 2011. Academy Senior Life Fellow Nancy Bennett delivered testimony July 9 to NCOIL warning that STOAs undermine the annuity marketplace in a way that is harmful to consumers. Cande Olsen, chairperson of the Life Products Committee, delivered similar testimony on May 20 to the NAIC Life Insurance and Annuities (A) Committee.

Massachusetts H889: To Allow Gender Pricing at the Savings Bank Life Insurance Company

The Life Products Committee (LPrC) sent a letter to Massachusetts Gov. Patrick on June 4 regarding a bill (H889) that would allow gender pricing to be practiced at the Savings Bank Life Insurance Company (SBLI). In the letter, the LPrC encouraged Massachusetts to bring actuarial science back to SBLI pricing and concluded that if SBLI pricing continues to become more polarized by gender, solvency will become more difficult to maintain. The LPrC added that unless gender pricing is permitted, not only will SBLI have trouble providing low cost insurance and annuities, but "safe" insurance also will be harder to provide. Gov. Patrick signed the bill into law on July 25 (Mass. Gen. Laws Ch. 176, 2010).

Pension Practice Council

Cost Accounting Standards (CAS)

The Pension Committee sent comments to the Cost Accounting Standards Board on July 9 regarding the notice of proposed rulemaking (NPRM) for harmonization of Cost Accounting Standards Nos. 412 and 413 with the Pension Protection Act of 2006 (Pub. L. 109-280). In the letter, the committee expressed the actuarial community's concern that certain elements of the NPRM will produce results that may prevent plans from meeting the objective of harmonization with the PPA. After modeling the NPRM provisions in simple PPA/CAS harmonization forecasts, the committee reported that the indication is that the NPRM does not effectively recognize PPA funding under CAS Nos. 412 and 413. The proposed addition of unnecessary triggers, the elimination of mandatory amortization of mandatory prepayment credits, and the basis for settlement accounting all require revision so that the final rule would achieve harmonization with consistent and equitable results.

Defined Benefit Pension Plan Relief

President Obama signed into law H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act (Pub. L. 111-192), on June 25. H.R. 3962 was a six-month Medicare doctor-payment extension; pension relief provisions were incorporated to help offset the cost.

The funding relief grants pension plan sponsors an extended period of time to account for investment losses incurred during the economic decline. Sponsors may elect an extended nine-year amortization period for up to two plan years during the four-year period from 2008 to 2011, paying interest only in the first two years of that nine-year election. This represents a change from the seven-year amortization period under current law. For pension plans not yet subject to the funding rules of current law under the PPA, a 15-year amortization schedule for one plan year is available.

Plan sponsors that elect to extend their amortization periods would be required to make additional contributions to their pension funds if they pay employees in excess of $1 million a year, pay out extraordinary dividends to shareholders, or redeem in excess of 10 percent of the market capitalization of their stock. For multiemployer pension plans, the option of a 30-year amortization schedule is now available, a change from the current 15-year period available under current law.

Measurement of Assets and Liabilities; Underfunded Pension Plans

The Pension Committee sent comments to the Department of the Treasury and the Internal Revenue Service in late March regarding final regulations on pension funding and benefit restrictions under Internal Revenue Code Sections 430 and 436 (T.D. 9467, 74 F.R. 53004). In the letter, the Pension Committee addressed several issues relating to these final regulations on pension funding and benefit restrictions, including:

- Establishing assumptions for unpredictable contingent event (UCE) valuations;
- Determining attribution rates for benefits that are not based on service or accrued benefits;
- Avoiding double payment for cost of certain amendments;
- Applying restrictions on accelerated distributions to a cash refund annuity;
- Determining the effective interest rate for plans that pay lump sums;
- Determining the funding target for an annuity option in a cash balance plan; and
- Issuing range certifications following deemed immaterial changes.

Implementation of Funding Relief Provisions

The Internal Revenue Service on Aug. 16 published IRS Notice 2010-55 and IRS Notice 2010-56, providing guidance on the implementation of funding relief provisions of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act (Pub. L. 111-192). IRS Notice 2010-55 describes the funding rules sponsors of single-employer defined benefit pension plans can use to make up for funding shortfalls. The notice provides guidance on filing Form 5500 and Schedule SB for single-employer defined benefit plans for plan sponsors that are considering use of the special funding rules under Section 430(c)(2)(D) of the Internal Revenue Code, as added by Section 201(b)(1) of the Act. New Section 430(c)(2)(D) permits a plan sponsor to reduce a plan's minimum required contribution for certain years by electing to use an alternative shortfall amortization schedule. This notice also describes anticipated future guidance that will apply to sponsors of single-employer defined benefit pension plans with respect to an election to use these special funding rules.

IRS Notice 2010-56 pertains to the special funding rules for multiemployer defined benefit plans. It provides guidance on filing Form 5500 and Schedule MB for multiemployer defined benefit plans for plan sponsors that are considering use of the special funding rules under Section 431(b)(8) of the Internal Revenue Code, as added by Section 211(a)(2) of the Act, for a plan year for which the Form 5500 (and Schedule MB) is filed. This notice also describes anticipated future guidance that will apply to sponsors of multiemployer defined benefit pension plans with respect to the special funding rules under Section 431(b)(8).

Multiemployer Pension Plans Funding Relief

The Pension Committee and the Multiemployer Subcommittee commented May 4 on multiemployer pension plan provisions included within H.R. 4213, the American Workers, State and Business Relief Act of 2010 (Pub. L. 111-205), which became law on July 22. The Academy groups expressed concerns about certain aspects of the bill's provisions that could be misinterpreted and offered suggestions as to how these provisions could be clarified. The Academy groups suggested that:

- The legislation should clearly indicate the manner in which the "net investment loss" is determined and how the special year amortization bases should be established to enable plans to take advantage of the relief quickly.

- The number of years over which the relief provision will be amortized should be clarified as starting at 30 years, reducing by one for each subsequent year that the relief is allotted.
- Issues related to timing and retroactivity questions in connection with the development and amendment of funding improvement and rehabilitation plans, as well as the interaction of the relief with previously issued certifications, need to be addressed.

Before H.R. 4213 became law on July 22, the pension plan provisions were stripped from the bill and inserted into the text of H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act (Pub. L. 111-192). H.R. 3962 was a six-month Medicare doctor-payment extension; pension relief provisions were incorporated to help offset the cost. President Obama signed H.R. 3962 into law on June 25.

PBGC Proposed Regulations

The Academy's Pension Committee sent comments on Jan. 22 and Jan. 25 to the Pension Benefit Guaranty Corporation (PBGC) on proposed regulations concerning reportable events under ERISA Section 4043 and the purchase of irrevocable commitments prior to initiating a standard plan termination under ERISA Section 4041.

In the Academy's Jan. 22 comments on ERISA Section 4043, the Pension Committee suggested that the PBGC reconsider providing reporting waivers when an otherwise reportable event poses minimal risk to the system. The committee added that further increasing the administrative burdens of maintaining defined benefit plans will deter the sponsorship of those plans and that additional reporting under these proposed regulations would not provide sufficient value to the system to justify the added cost.

In the Jan. 25 comments on ERISA Section 4041, the Academy's Pension Committee concluded that adopting policies that encourage annuitization by plan sponsors would be consistent with the PBGC's mission to protect workers' retirement income by providing timely and uninterrupted payment of pension benefits. The committee added that the ability to purchase irrevocable commitments prior to initiation of a standard termination is consistent with published public policy of the Department of Labor.

Social Security Trustees Report

The Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance (OASDI) Trust Funds released its 2010 report on the financial status of the Social Security program on Aug. 5. The report indicated that the 75-year outlook of the program has improved slightly, primarily because of a provision in the Affordable Care Act (ACA) [Pub. L. 111-148] that is expected to cause a higher share of labor compensation to be paid in the form of wages subject to the Social Security payroll tax. Under the Trustees' best-estimate set of assumptions, however, the combined OASI and Disability Income (DI) trust funds are projected to become exhausted in 2037, the same year of exhaustion as was projected in the 2009 report.

According to the report, the DI trust fund is projected to become exhausted in 2018, which may necessitate a reallocation between the OASI and DI trust funds. For the combined OASDI programs, benefits and administrative expenses are expected to exceed tax income in both 2010 and 2011 because of the effects of the recession. The cash flow is projected to become positive again from 2012 through 2014, but then become negative in 2015 and remain so for the remainder of the 75-year projection period. Beginning in 2025, expenditures are projected to exceed tax income plus interest on the trust fund assets, requiring the program to begin drawing down trust fund assets. After trust funds are exhausted in 2037, annual revenues are projected to cover only 78 percent of promised benefits, decreasing to 75 percent at the end of the projection period in 2084.

The annual cost of benefits in 2009 was 4.8 percent of GDP. This is expected to rise to 6.1 percent of GDP by 2035 and remain between 5.9 and 6 percent through 2084. Social Security's 75-year actuarial deficit is projected to be 1.92 percent of taxable payroll, which is down from last year's projection of 2 percent. According to the report, this improvement is primarily the result of a 0.14 percentage point reduction due to the ACA provision that would slow the rate of decline in the share of employee compensation paid as taxable wages. The report provides program costs and balances over the 75-year projection period as a percent of covered payroll, as a percent of GDP, and as an open group unfunded obligation. The report also provides some results over an infinite horizon.

The Academy updated its annual issue brief on the Trustees Report and the future solvency of Social Security in October. In addition to the Trustees Report issue brief, the Academy's Social Insurance Committee in June updated an existing issue brief, *Social Security Reform: Changes to the Benefit Formula and Taxation of Benefits*. In conjunction with the Pension Committee, the Social Insurance Committee also made suggested changes to specific Social Security Administration resources designed for workers 55 or older who are thinking of retiring.

Risk Management and Financial Reporting Council

Group-wide Regulatory Requirements

The Academy's Risk Management and Solvency Committee (RMSC) submitted comments on Aug. 10 to the Insurance Groups and Cross-sectoral Issues Subcommittee of the International Association of Insurance Supervisors (IAIS) on its *Draft Standard on Group-wide Regulatory Requirements and Guidance on Group-wide Supervision Framework.*

In addition, the RMSC sent comments on April 30 to the Solvency and Actuarial Issues Subcommittee of the IAIS on its *Guidance Paper on Capital Adequacy for Regulatory Solvency Purposes.*

Revenue for Incremental Acquisition Expenses

The Academy's International Financial Reporting Committee (IFRC) commented in February on the vote by the International Accounting Standards Board (IASB) and confirmation by the Financial Accounting Standards Board (FASB) to not permit the recognition of revenue for incremental acquisition expenses upon the initial measurement of an insurance contract. The IFRC recommended that any calibrated margin, whether a residual margin or a composite margin, be calibrated to the premium at inception net of incremental acquisition costs. The IFRC added that the resulting liability value will provide the most faithful representation of the economic value of the insurer's obligation under the contracts.

The Academy's Life Financial Reporting Committee and Financial Reporting Committee commented in February on the FASB exposure draft, *Proposed ASU-Financial Services-Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. In the letter, the committees noted that they had concerns about some of the specifics of the proposed guidance, such as the disparate treatment of non-incremental, direct costs depending on whether the costs represent salary or employee benefits versus other types of costs.

GAAP Accounting Standard for Insurance

The IFRS Task Force sent comments to the IASB on its Insurance Contracts Exposure Draft on a new generally accepted accounting principles (GAAP) accounting standard for insurance and comments to the FASB on its accompanying discussion paper, *Preliminary Views on Insurance Contracts*.

Before the release of the standards, the Academy's IFRS Task Force hosted a webinar to present an introduction to the work of the IASB, an overview of the exposure draft, and to review the implications of the changes to general purpose insurance contract accounting. Slides from the webinar can be found here.

Solvency Modernization

The Academy's ERM Subcommittee commented on the NAIC's Solvency Modernization Initiative (EX) Task Force's *Consultation Paper on Corporate Governance and Risk Management* on Feb. 26. In addition, the Regulatory Capital Requirements Task Force responded to questions posed in the *Consultation Paper on Regulatory Capital Requirements and Overarching Accounting and Valuation Issues for the Solvency Modernization Initiative*.

If you have any questions regarding the information in this Alert, please contact Justin Edwards, the Academy's Legislative Assistant (edwards@actuary.org; 202-223-8196).