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So What Has ARM Done Lately?

By Corwin Zass

Over the last month, our firm has participated in a wide range of events across the insurance sector.

(1) In late February, our firm presented in NY to a diverse crowd consisting of investment banking analysts, rating agency professionals and accountants who provide advisory services to insurers. Our presentation was part of a workshop on how to value an insurance company for acquisition purposes, covering the life, health and casualty sectors. Specifically, ARM provided insight into actuarial appraisals, their uses, and the differences between the appraisal and other valuation techniques, including market-based approaches, dividend discount modeling, and various "rules-of-thumb". We discussed the uniqueness of the insurance sector, including the differences between statutory and GAAP accounting, while providing some insight to understand and overcome the particular challenges inherent in valuing insurance carriers. The presentation was warmly welcomed by the many participants in attendance and we have received different follow up inquiries on the complexities of accounting for insurance carriers, specifically the differences in accounting treatment between various insurance products, including GAAP vs. statutory-based reporting and how reserves can be used to "manage earnings".

(2) In early March, our firm attended a small workshop in NY on implementing a more proactive approach in assessing and managing operational risks for insurance companies. The program had ARM playing a unique role, as the sole actuarial attendee, by providing the workshop with the "actuaries' perspective" to that of the other operational risk managers within the insurance sector. The discussions ranged from the steps involved with implementing a robust operational risk management framework to quantifying the impact of operational risk on capital requirements and corporate governance to the impact of using sound enterprise risk management processes. Given the impact of Solvency II on the other side of the pond, the movement towards required ERM approaches on this side of the Atlantic is not far off.

(3) Actuarial Risk Management was the sole actuarial provider selected to participate in an employee benefit summit in Phoenix in mid March. The international information company, Marcus Evans, hosted the Corporate Benefit Summit at the beautiful Arizona Biltmore. ARM had 30 one-on-one meetings with some of the largest multinational companies, ranging from Wal-Mart to JELD-WEN to ARAMARK, to discuss ways to minimize employee benefit costs. These senior benefit executives and ARM representatives, including myself and Jim Galasso, interacted very closely over the three-day event. The summit was set in an environment in which industry leaders offered valuable insight into their benefit management strategies through the one-on-one meetings. ARM discussed benefit cost initiatives, which help corporations contain the costs of providing health care benefits, decisions on plan design, funding and contribution strategy, flexible benefits programs, employer purchasing coalitions, plan performance management and retiree medical benefits.

Events

April 21–22

IASB/FASB Joint Board Meeting
London, UK

May 5–6

8th Annual Product Development Actuary Symposium
Tampa, FL

May 15–16

Advanced Financial Reporting
New York, NY

May 28–30

SOA Health Spring Meeting
Los Angeles, CA

May 31–June 3

NAIC Summer Meeting
San Francisco, CA

June 2–5

2008 Reserves Week
Chicago, IL

June 4–6

SOA Employee Benefits Spring Meeting
Tampa, FL

June 9–13

Asset Liability Management
Toronto, Canada



ARM: Who We Are

Actuarial Risk Management (ARM) is an independent member of the BDO Seidman Alliance. ARM's staff, along with the expert actuaries from ARM's Actuarial Consulting Network, provides all necessary actuarial expertise and tools to ensure we can cover all actuarial disciplines.

All ARM representatives must comply with strict ethics and standards. We have access to the latest technological tools, ranging from modeling software for our life clients to proprietary claims analysis tools for our health clients.

Our fees are aggressively competitive and our experienced actuaries provide you with objective, independent, and responsive actuarial consulting services.

Actuarial services include:

- Valuation and Financial Reporting
- Predictive Modeling & Loss Forecasting
- Corporate Modeling
- Reinsurance Expertise
- Expense Allocations and Analysis
- Capital Management
- Mergers and Acquisitions, Due Diligence
- Statutory, Tax and GAAP Audits of Actuarial Assets & Liabilities
- Data Management
- Product Development and Competitor Analysis
- Sarbanes-Oxley Assistance
- Retirement and Pension design and valuations
- Alternative risk management solutions, including captive and self-insurance



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Around the Actuarial World in 2 Minutes...

This month's highlights

By Corwin Zass



1. New Captive Insurance Legislation

On March 13th, Michigan's Governor signed legislation allowing the formation of captive insurance companies in the state. Unlike many other states with captive laws, the Michigan measure does not impose premium taxes but instead charges captive parents fees linked to premium volume. The law also allows employers to form branch captives, which businesses typically use with offshore captives that want to fund employee benefit risks. The captive law goes into effect immediately.

2. IRS Withdraws Proposed Regulation Affecting Captive Insurance Companies

On February 20, 2008, the Internal Revenue Service announced that it was withdrawing proposed Regulation §1.1502-13(e) on consolidated returns after considering written technical comments. Under the IRS proposal, certain intercompany insurance transactions would have required tax accounting on a single-entity basis, and this would have virtually eliminated the tax benefit of reserves in a captive.

3. FASB Issues Proposed FASB Staff Position

FASB issued proposed FASB Staff Position (FSP) No. 132(R)-a, Employers' Disclosures about Postretirement Benefit Plan Assets. The purpose of the proposed FSP is to obtain feedback from constituents on proposed guidance intended to improve the quality of financial reporting by increasing disclosures about the types of assets held in postretirement benefit plans. Respondents have until May 2, 2008, to provide comments. This proposed FSP would amend FASB Statement No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, to improve public and nonpublic employer's disclosures about postretirement benefit plan assets. Additionally, this proposed FSP includes a technical amendment to Statement 132(R) that would require a nonpublic entity to disclose net periodic benefit cost.

4. AAA Issues a Medical Malpractice Fact Sheet

The American Academy of Actuaries, which serves the public on behalf of the U.S. actuarial profession, in March released a fact sheet on the types of medical malpractice insurance policies. The fact sheet is the first in a series of one-page informational fact sheets, issued by the American Academy of Actuaries' Medical Malpractice Insurance Subcommittee, for use by actuaries and the public. You may download this fact sheet at http://www.actuary.org/pdf/casualty/medmal_fact_march08.pdf

NAIC exploring effects of Life Reinsurance Trust Collateral

By Corwin Zass

The National Association of Insurance Commissioners (“NAIC”), Kansas City, Mo., has a subgroup of the NAIC’s Capital Adequacy Task Force (CATF) that released for a 21 day comment period a proposal that discusses the topic of trustee collateral. Under the current rules, the computation for net reinsurance ceded risk does not provide a credit charge offset for reinsurance contracts with authorized reinsurers supported by trustee collateral.

Issue

The computation of the net reinsurance ceded risk requirement (gross statement value from Schedule S less 100% owned affiliates) does not provide a reduction in credit charges for reinsurance contracts with authorized reinsurers supported by collateral in reinsurance trusts. Reinsurance secured under funds held arrangements do receive a credit charge offset. Reinsurance arrangements secured with trustee funds held by an authorized reinsurer are equivalent to funds held arrangements and should (but does not) receive the credit charge offset.

Background

The counter-party credit risk component of life reinsurance ceded is captured in Life Risk Based Capital in the C-1 risk category (RBC LR014 – Reinsurance). The statement value for amounts listed by a reinsurer on Schedule S, Part 2 and Part 3, are used to generate the beginning amount to calculate a risk charge for reinsurance ceded.

Authorized reinsurers are the reinsurers licensed to do business in a state or jurisdiction; non-authorized reinsurers are the complement (i.e. not licensed). When insurers do business with non-authorized reinsurers (not authorized in their state of domicile), the resulting reinsurance treaties must be backed with letters of credit (LC), a trust agreement, funds withheld or other guarantees. Reinsurance arrangements secured with “funds withheld” arrangements qualify for a credit charge offset, but agreements secured by trustee collateral do not qualify. Funds withheld are monies a ceding company holds to get credit for non-admitted reinsurance, to reduce credit risk or to retain control over investments. Some reinsurers are arguing that funds in a trust are equivalent to the funds withheld and ought to qualify for the same offset.

Summary and Conclusion

Recommend a non-substantive technical amendment to the Life RBC instructions for the computation of reinsurance ceded to reduce the net statement value for trustee collateral used to secure reinsurance ceded with authorized reinsurers. Trustee collateral held by an authorized reinsurer may be considered legally and economically equivalent to funds held for purposes of credit risk if there is evidence of periodic draws upon such collateral and such collateral already meets the requirements set forth in the Credit for Reinsurance Model Law and Regulations, “New York Regulation 114”, and as codified in Appendix A-785, Credit for Reinsurance as regards allowance for ceded claim reserves.

Trustee collateral for authorized reinsurers can be posted in the Life RBC workfile on the line for Funds Held in Authorized Reinsurers, thus requiring no additional lines or changes in the formula.

Other Post Retirement Benefits (OPEB) – Actuaries Are Helping Find Funding Solutions

By Corwin Zass

The Government Accounting Standards Board (GASB), which regulates municipalities, school districts, state and local governments and other public entities, states these entities must now value and recognize OPEB obligations under GASB 43/45. Some estimate the unfunded obligations for all government agencies may be close to 1 trillion dollars. These government entities are struggling with what will be likely the largest liability for them. There is a three-year period for implementation. Entities with revenue of more than \$100 million will be recognizing first, while entities with revenue under \$10 million will be required to recognize these obligations by the third and final year of required implementation.

These entities are hiring actuarial firms to quantify the problem. Actuaries are determining how big the liabilities are for each OPEB obligation (e.g., retiree medical dental, vision, prescription drugs, life insurance, long-term care and other benefits.) Workers' compensation may not need to be valued if currently valued today under other obligations (GASB No. 10). Benefits offered may have multiple options, multiple plan designs (e.g., legacy benefit designs from collective bargaining) and multiple retiree contribution rates, which might vary based on hire dates, collective bargaining, or types of member (retiree, dependent, surviving spouse, etc.).

Currently, these public entities value these costs on a pay-as-you-go basis. Prior to FAS 106, large employers were doing this as well. A pay-as-you-go approach unfortunately does not value the impact of vesting benefits for current active employees that are earning these retirement benefits, nor is it reflecting the impact of inflation on this benefit. A public entity that spends \$5 million a year in retiree benefits may have a liability more like \$50 million to \$100 million. For private sector's employers, they valued these benefits in the early to mid 1990s under FAS 106, more recently FAS 132 & 158.

A little background on GASB 43 & 45.

The key terms are the Annual Required Contribution (ARC) and Unfunded Accrued Liability (UAL). These are comparable to concepts in the pension arena for defined benefit plans. The ARC is the employer's periodic contribution to the defined benefit OPEB plan and used to determine the expense and liability values that appear on the employer's financial statements for the purposes of GASB 45. The UAL is the excess of the accrued liability of benefits, which would be the present value of future benefits accrued and earned to date less future contributions, and the existing assets already funded for the plan.

Actuaries value the ARC and UAL, which are material and greater than the costs reported today, which are on a pay-as-you-go basis. Under GASB 43 and 45, actuaries will value benefits for both current retirees (and dependents) as well as future retirees (actives that will potentially retire in the future). Those active employees will generate a significant liability especially if they potentially could retire in their 50s or even in their 40s.

Continued on page 7



Actuarial Topics Affecting Audits

By Corwin Zass

TOPIC (1) In late 2007, the American Academy of Actuaries asked the Society of Actuaries to conduct research that illustrates the potential effect of the proposed IASB accounting model on U.S. insurers with life and health insurance and annuity contracts.

The focus of this research is the development of baseline illustrative financial statement results using the accounting model. In addition, the research team developed corresponding values using current U.S. GAAP standards, which may be particularly relevant to the FASB's deliberations regarding whether it should join the IASB in a joint insurance contracts project.

The SOA completed a product review in late February 2008 to illustrate the differences. You may download the review at <http://soa.org/research/life/research-financial-standards.aspx>



TOPIC (2) The International Accounting Standards Board (IASB), London, and the Financial Accounting Standards Board (FASB), Norwalk, Conn., recently discussed the pros and cons of proposed fair value insurance accounting standards.

The insurance industry is not so happy. The chair of the Group of North American Insurance Enterprises (GNAIE), Jerry de St. Paer, recently stated, "Including fair value, an untested method, could do very serious harm to the global insurance industry." The calendar is quickly advancing, and GNAIE noted "that an exposure draft for new accounting standards could be issued by the end of 2009, and cautioned that if the U.S. market doesn't weigh in on principles being developed, then implementation may be the only thing left to comment on."

Wayne Upton, director of research with the IASB, noted that there is a growing sense that the "U.S. is becoming an outlier, and in the long term this is just not tenable." Mr. Upton said there would be additional expense of continuing to use U.S. Generally Accepted Accounting Procedures standards if the new international standards become the global norm.

To say that some of the larger US insurers are at odds with the general movement toward the fair value approach is somewhat of an understatement.

TOPIC (3) Recently, various insurance company executives gathered for a roundtable discussion on the effects around statutory principles-based reserve and capital regulations (PBR), the convergence of the US Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS), and Solvency II.

The group acknowledged the challenges ahead, and there was an over-riding consensus that the industry is struggling to understand and prepare for the impact on the business. Despite the fact that the regulations are still in flux, participants agreed that companies who seek to understand the ramifications of the coming changes in advance of their adoption will be in a better future position and that the time is right to begin mapping out a plan for meeting the new requirements.

To learn more about the principles-based movement that will impact U.S. insurers in the years to come, please call us.

Meet One of ARM's Experts

By Evelina Kaminski

Lawrence G. Scott

Larry is vice president and qualified actuary with ARM and has been a consulting actuary for most of his career. Larry brings wide-ranging experience to insurance carriers in the areas of life and annuity product development, statutory and GAAP accounting, financial reporting, asset liability management, pricing and valuation systems, experience analysis, and appraisal analysis.

In the last 5 years, Larry has completed various state examination assignments of very large insurance companies. Larry's ability to conduct audits in a cost effective and thorough manner is crucial in ARM's assignments. His ability to talk with non-actuaries about actuarial issues is the exception rather than the norm in the industry but not for ARM.

Prior to joining ARM's predecessor in 2002, Larry was assistant VP and consulting actuary with the regional firm of Lewis & Ellis, Actuaries & Consultants in Dallas and Los Angeles. Before entering the consulting area, Larry began his career with Executive Life Insurance Company and held the position of Actuarial Assistant between 1978 and 1981.

Larry is an Associate of the Society of Actuaries and a Member of the American Academy of Actuaries.

Other Post Retirement Benefits (OPEB) - *continued*

The actuarial valuations use various assumptions, including the health care (trend) rate, discount rate, retirement rates, turnover rates, disability rates, mortality rates, aging assumptions (age/sex factors), asset return on investments (if any of the entities are funding benefits), salary increases if benefits or funding is based on salary (e.g., life insurance), plan participation percentage (some individuals may opt out) and actuarial cost methods.

An important thing to know about GASB 43 and 45 is that it establishes standards for accounting and financial reporting. The public entity decides on the level of funding, with the option to either pre-fund these obligations now or wait until later. The holes are large and how you fill them create no "cookie cutter" solutions given the uniqueness on the solution sets.

Call ARM to learn more on GASB 43/45 and to learn more about funding solutions available to these government entities.

Looking forward to hearing from You – How and where can we work together?



If you have comments or suggestions for this newsletter, or if you have questions about our business, do not hesitate to e-mail us at newsletter@actrisk.com

Our Services

Actuarial Risk Management offers a wide range of services. Some of our services include:

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Risk Review is published electronically by Actuarial Risk Management, an independent member of the BDO Seidman Alliance, to provide members the latest news and information about managing risk.

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Life & Annuity:

- Financial Reporting Duties for Statutory, Tax, GAAP, and IFRS
- Audits of Actuarial Liabilities
- Principle Based Capital and Reserves
- Economic Capital
- Value Based Management
- Merger, Acquisitions and Restructuring
- Products, Markets and Distribution
- Risk Assessment
- Reinsurance
- Expert Witness
- Experience Studies
- Sarbanes-Oxley / Model Audit Implementation

Who Are Our Clients?

- Insurance Companies
- Regulators
- Agencies
- Business Owners
- Hospitals
- Managed Care Providers
- Employers
- Hedge Funds
- Private Investors

Employee Benefit:

- Medicare Part D Assistance and Analysis
- Pricing of Group Medical, Dental, Disability, Life, Drug Plans
- Strategic Planning and Management Analysis
- Plan Funding (fully insured or self-insurance)
- Actuarial Plan Projections and Forecasts
- Self-Insurance Feasibility Studies
- Cost Containment Program (identification & evaluation)
- OPEB Valuations and Program Assessments (under FASB, GASB)

Managed Care:

- Valuation & Financial Reporting
- Provider Network Evaluations
- Benefit Plan Pricing & Premium Rate Filings
- Small & Large Group Underwriting
- IBNR Analysis
- Financial Reporting & Projections
- Predictive Risk Modeling
- HSAs & Consumer Driven Health Plans
- Actuarial Training Programs (Managed Care specific)
- Payor Drug Cost Reviews
- Expert Witness

Property & Casualty:

- Outstanding Claims Liability, IBNE, IBNR and Loss Reserve Analysis
- Product Profitability & Company Capital Management
- Excess Insurance Evaluations
- Loss Forecasts and Historical Profitability Analysis
- Models for Dynamic Financial & Cash Flow Analysis
- Cost Driver Analysis
- Reinsurance & Risk Transfer
- Relativity Factors
- Deductible Credits
- Regulatory Assistance
- Self-Ins. and Captive Prgms
- Audit Support
- Expert Witness

Retirement:

- Actuarial Funding Valuations
- Accounting Valuations and Disclosures (FASB 87, 88, 106, 112, 132, 158)
- Government Plan Valuations (GASB 25, 27, 43, 45)
- Claims Analysis
- Forecasts and Projections
- Plan Design, Evaluation and Re-Design
- Opinions / Recommendations on Assumptions

