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AAA Releases Brief On Unpaid Claim Estimates



The American Academy of Actuaries (AAA) Committee on Property and Liability Financial Reporting (COPLFR) prepared in September 2008 an issue brief directed primarily toward actuaries with the goal of ultimately improving casualty actuaries' communications with regard to ranges of unpaid claim estimates. This brief covers insurers' and non-insurers' claim estimates.

This issue brief focuses on the use of ranges to depict the inherent uncertainty in determining unpaid claim estimates and outcomes for property/casualty liabilities. It explores some of the major themes in the calculation and use of ranges of unpaid claim estimates, including, in particular, the term "reasonable range." Clear communication of an insurance entity's or other organization's risk and recorded reserve with respect to a range of unpaid claim estimates can assist regulators, management, investors, auditors, and policyholders in determining strategies in their evaluation of such entities or organizations.

This issue brief provides:

- An introduction section describing why a range may be used and, in particular, the use of a "reasonable range;"
- A description of the types of ranges that exist and why and how such estimates are developed;
- Characteristics that define transparent and understandable disclosures of unpaid claim estimate ranges.

The appendix of the issue brief contains a discussion of the interaction of uncertainty, conservatism, and bias when a single estimate needs to be selected with respect to a range of unpaid claim estimates.

Additionally, there are comments on accounting guidance with respect to this topic.

Events

October 19-22

SOA 08 Annual Meeting
& Exhibit
Orlando, FL

October 22-24

Future of Life-Cycle
Saving and Investing
Boston, MA

October 27-28

Equity-Based Insurance
Guarantees Conference
Boston, MA

October 29

Dynamic Hedging
Master Class

November 5

Reviewing and
Validating Actuarial
Models Webcast

November 6

Pandemic Flu Webcast

November 10-11

Intro. To Predictive
Modeling: Techniques
and Applications for Ins.
Actuaries

November 16-19

CAS Annual Meeting
Seattle, WA

December 3-4

Effective P&C Loss
Reserve Opinions
Baltimore, MD

December 4-5

Market Consistent
Embedded Value



ARM: Who We Are

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

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.

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Around the Actuarial World in 2 Minutes...

This month's highlights



1. AAA's Contingency Magazine – September/October 2008 Issue has the Presidential Candidates Facing Off on Health Care Reform

This issue of Contingencies focuses on the differences between the two candidates vying for the White House. Regardless of who is the next President and who controls Congress, each will need to address the many challenges facing the health care system, and the success of their efforts will depend on the approaches they use to attend to access, cost, and quality issues.

To download each candidate's plan, please visit the following link...

<http://www.contingencies.org/septoct08/mccain.pdf>
<http://www.contingencies.org/septoct08/obama.pdf>

Stay tuned as see if the debates alter their positions...

2. News from the American Academy of Actuaries

- A. The Health section of the AAA recently released the "Report from the Health RBC Trend Test Work Group to the NAIC on evaluating the effectiveness of three alternative trend tests from the original two tests. (August 2008) "

Academy Charge was:

- To determine if a leading indicator based on annual financial statement information can be developed to identify those companies with reported Health Risk-Based Capital ratios above 200 percent, the company action level (CAL), that face a significant risk of subsequently falling below 200 percent in the following year or near term. For these purposes, the indicator is referred to as a "trend test" and companies reporting above 200 percent in one year but falling below 200 percent in the next are referred to as the "target group."
- To examine in particular whether the following, referred to as the "straw man benchmark" (Trend Test 1), is a suitable candidate for the desired indicator: companies with an HRBC ratio between 200 percent and 300 percent and a combined ratio greater than 105 percent.

- B. Progress reports to the NAIC from two Academy health RBC Work Groups (August 2008)

- **The Medicare Part D RBC Subgroup** - Currently working on updating its 2005 report to the NAIC on Medicare Part D RBC Risk Factors. The purpose of this update is to address changes in the Part D risk-taking structure, and to incorporate company information now that the companies have experience in operating Medicare Part D plans.
- **Stop Loss Work Group** - Continues its work in refining the update of the 1994 report to the NAIC on stop-loss factors. The Academy is working collaboratively with the Society of Actuaries to review and create a new statistical analysis of the data because of inconsistencies identified in the prior analysis.

- C. Progress report to the NAIC from a Long-Term Care RBC work group (August 2008)

The Long-Term Care Principle-Based Work Group is continuing work on a stochastic model for long-term care insurance. An initial prototype has been developed and is being reviewed. The work group has also initiated dialogue with the Society of Actuaries' Long-Term Care Valuation Group regarding morbidity assumption data. No specific timetable has been identified for delivery of the final report.

What is the Fuss with Equity-Indexed Products...

In September, the American Academy of Actuaries's Equity Indexed Annuities Work Group presented its initial comments on the Securities and Exchange Commission's proposed Rule 151A. The highlights are as follows:

1. Proposed rule 151A would define indexed annuities as securities on a basis which is inconsistent with prior determinations of securities status and with commonly understood differences between insurance and securities.
2. The Academy Work Group believes the determination of the status as a security should be based on the presence of variance that includes the risk of loss of principal, not the uncertainty of interest earned above principal and interest guarantees.
3. The proposed rule will negatively impact values available to the consumer.
4. As currently written, the Academy Working Group predicts several unintended consequences of the proposed rule as well as many unanswered questions. For example, it is not clear whether the proposed rule would apply to other insurance products in addition to indexed annuities.
5. While the Academy Working Group understands the concerns that have been raised leading to the proposed rule, state regulators and the insurance industry have been working to address them. Some remedies are already in place and others are in process to address the SEC's concerns. That these items are in process of development is an important reason why the Academy had previously requested a 90-day extension to the comment period. There are sound demonstrations that can be shown to clarify the value and purpose of indexed annuities as legitimate alternatives to the risks of a security.

Principles-Based Reserving – An Update

The NAIC completed its 2008 Fall National Meeting in late September. The NAIC continued its work towards the development of principles-based reserve requirements for life insurers. The shift toward reserve requirements using broad principles is a complete 180 degree turn from current rules-based approaches.

The Life and Health Actuarial Task Force ("LHATF") continued reviewing the May 31, 2008 exposure draft of a revised Standard Valuation Law. The revision will allow states to follow the requirements of a Valuation Manual, as revised periodically by the NAIC, without having to adopt new legislation or regulations. The intention of the Valuation Manual is to serve as the reserving component for the NAIC Accounting Practices and Procedures Manual. Many expect LHATF to expose a revised SVL draft for comment in early October 2008 while targeting adoption prior to the NAIC's 2008 Winter National Meeting.

Additionally, the NAIC presented a Principles-Based Reserving Education Session, which included presentations by state insurance regulators, the American Academy of Actuaries and others. This session discussed the history and concepts of the proposed principles-based reserving approach along with a cost-benefit analysis. The main thrust for the movement was the need to have the U.S. insurance regulatory system evolve to allow U.S. insurers the ability to compete more effectively in global markets. Many of the insurance and annuity products currently found throughout the world have complex embedded options and risks that are not able to fit into the few "circles" of the current formulaic reserving methods. This creates inconsistent applications, or interpretations, in reserving for these newer insurance products. Outside of the U.S., most reserving regimes permit insurers to hold reserves, producing results more closely correlated to economic reality.

Stay tuned...

NAIC Model Audit Rule Survey Results – August 2008

The Annual Financial Reporting Model Regulation, commonly referred to as the Model Audit Rule, was revised in 2006 to incorporate certain best practices related to auditor independence, corporate governance and internal control over financial reporting. The amendments require that insurers with \$500 million or more in direct and assumed premium annually prepare management's assessment of internal control over financial reporting. A survey is being sent out quarterly to track states' progress in adopting the revisions.

We summarize below the answers provided by the states in August 2008, stay tuned as NAIC "SOX" moves closer to reality...

QUESTION 1: Will your state be incorporating the revisions through a statute or will it be done through a regulation?

Statute/Law	15	Regulation/Rule	29
Combination	7	Unknown	0

QUESTION 2: When does your state intend on either presenting the amendments to your legislature or making the change to a regulation?

Completed - 3 2008 - 18 2009 - 27 2010 - 0 Unknown - 3

QUESTION 3: Have you publicly released or exposed proposed changes to your statute or regulation at this point? If so, please comment on the status and any problems/issues encountered so far.

- Virginia, Alabama and Oregon have publicly released – and subsequently adopted – changes to their regulation.
- Connecticut, Delaware, Nebraska, South Carolina and Wisconsin have publicly released changes to their regulations – but not yet adopted.
- California and Alaska have publicly released – and Alaska has adopted – enabling legislation, but have not yet released proposed regulations to incorporate the 2006 revisions. No states reporting significant issues.

Claims Reserving for Medical Insurance Intermediate Topics

In late September, one of ARM's Network actuaries, James P. Galasso, FSA, MAAA, moderated a discussion on practical applications of more advanced claim reserving techniques for medical insurance along with a summary of recent SOA research on stochastic methods for claim reserving.

The discussion featured the presentation of a practical application of claim reserving techniques, including:

- Multiple triangles (ICOS vs. IBNR)
- Workday adjustments
- Variation in completion factors by line of business and type of service
- "Other-than-monthly" completion factors for claims paid in unusual intervals
- Impact of large claims
- Automation of processes under pressure to provide results earlier in the month
- Combining statistical methods and actuarial judgment
- Communicating IBNR results

To learn more about Jim's presentation or have general inquiries about Medical Insurance, please contact us.

Risk-Based Insurance Exam

Carriers are in for big changes in the way regulators review their internal controls as examiners shift from rules to risk

Out with the old ... and in with the new, at last. The next couple of years are bringing some big changes in the way examiners are going to look over the books of insurance carriers as regulators move from a rules-based to a risk-based methodology for reviewing the internal controls implemented by insurance companies.

Under the old system, insurance company examiners went strictly by the book: earnings, balance sheets, income statements, statutory filings. If the numbers looked clean the company was assumed to be in good health. It doesn't quite work that way anymore. Now examiners are taking a more flexible and holistic approach that takes into account the broader context in which carriers operate. They want to know how companies manage risk exposures, and what structures are in place to make sure a company does so. Numbers are not all that matters.

Who's going to benefit? Investors, for one, along with insurance buyers and their brokers, as examiners will be more likely to accurately evaluate the risks to which carriers are exposed. In theory, it's all good news for buyers as they'll get fair warning about whether a carrier is overexposed and could have trouble paying future claims. The coming changes are important--perhaps even radical. We're not talking about changes in process. We're talking about a fundamental shift in the way insurance examiners interact with the industry they're supposed to be overseeing.

Take David G. DelBiondo, director of the Bureau of Financial Examination at the Pennsylvania Department of Insurance. DelBiondo practices his craft in a state that's seen its fair share of large insurance carriers--Legion and Reliance, for example--melt away into insolvency.

A decade ago, it was unheard of for a state examiner to sit in on a board meeting of a large or midsize insurance carrier. "I just couldn't imagine sitting on the board meeting of an insurance company in Pennsylvania," he said. But in the next couple of years, C-suite insurance executives ought not be surprised if they hear a knock on their boardroom doors, only to find DelBiondo's smiling face on the other side. In the past, when examiners would sometimes focus solely on a company's income statement or balance sheet, too often button-downed regulators would spend too much time on minor issues, approaching their tasks in "checklist" fashion, according to corporate comptrollers.

Those days--or should we say decades--are gone.

The changes come courtesy of the National Association of Insurance Commissioners, which ordered that state examiners obtain more information on insurance carriers beyond what was available in public filings.

Commissioners now expect examiners to have answers to questions such as, "How did companies use investments to manage and mitigate risks unique to that company?" said DelBiondo.

The NAIC ordered the changes in the wake of the Sarbanes-Oxley Act of 2002, which was passed in an attempt to inject more transparency and accuracy into financial accounting practices that previously allowed some companies to hide the real state of their balance sheets. The accounting scandals led to a series of spectacular corporate collapses that cost investors billions of dollars, and investors and regulators blamed the audit profession for not revealing the pitiful state of some corporate balance sheets. DelBiondo recommended that companies looking to prepare for their exams should engage senior management, the legal department, the risk management department, and internal and external audit personnel, and that managers involved in preparing for the visit should "meet early and often."

Meet One of ARM's Experts

Mickey G. McDaniel

Mickey McDaniel is a Senior Pension Practice Leader for Actuarial Risk Management (ARM). Mr. McDaniel provides full service retirement benefits consulting to employers with one-stop assistance for all aspects of retirement planning for their employees. He provides consulting expertise for ARM, via the independent consulting firm he founded, Retirement Horizons. He has an impressive track record of successes in business development and client relationship management. His experience in the actuarial and benefits consulting field includes:

- Retirement plan design across the full spectrum of programs including defined benefit and defined contribution plans, traditional and hybrid plans, qualified and nonqualified plans as well as postretirement health and welfare plans
- Implementation of retirement programs including preparation of plan documents for legal counsel review, IRS filings and other compliance support, employee communications and overall project management
- Ongoing plan administration including defined contribution recordkeeping, defined benefit plan calculations and personalized retirement plan statements
- Comprehensive actuarial valuation services to determine funding requirements and financial accounting disclosures



Prior to founding Retirement Horizons, Mr. McDaniel was Director-In-Charge of the Human Resource Advisory consulting practice of Coopers & Lybrand L.L.P. in Houston, Texas. He held a similar position as a Principal at William M. Mercer managing the office in Tulsa, Oklahoma. McDaniel has also served as a consulting actuary at Hewitt Associates and Towers Perrin.

Mr. McDaniel is an Associate of the Society of Actuaries and an enrolled actuary. He is also a member of the American Academy of Actuaries and the Pension Section of the Society of Actuaries. He graduated with high honors from the University of Texas at Austin with a Bachelor of Business Administration degree in Actuarial Science in May of 1979.

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

Also, visit our new website at www.actrisk.com

Our Services

2008 Actuarial Risk Management

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

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- Experience Studies
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- Hospitals
- Managed Care Providers
- Employers
- Hedge Funds
- Private Investors

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- 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